63D CONGRESS, 1st Session. } HOUSE OF REPRESENTATIVES. { REPORT No. 69.

CHANGES IN THE BANKING AND CURRENCY SYSTEM OF THE UNITED STATES.

SEPTEMBER 9, 1913.—Committed to the Committee of the Whole House on the state of the Union and ordered to be printed.

Mr. GLASS, from the Committee on Banking and Currency, submitted the following

REPORT.

TOGETHER WITH VIEWS OF THE MINORITY AND MINORITY VIEWS.

[To accompany H. R. 7837.]

The Committee on Banking and Currency, to which was referred the bill (H. R. 7837) to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes, having had the same under consideration, report it back to the House with certain amendments and recommend that the bill as amended do pass.

AMENDMENTS.

The amendments to the bill are almost without exception mere alterations of phraseology, made for the purpose of consistency or with a view to clarifying the meaning of certain provisions. Thus, in section 2, page 3, line 19, the word "subscriber" is stricken out and the words "member bank" substituted in order to conform the language to other provisions of the bill; and so in section 3, page 4, lines 14, 16, and 17, and in section 5, page 11, lines 15 and 21, and on page 12, lines 6, 7, 10, 13, and 16, and in section 6, page 12, lines 20 and 21, and on page 13, lines 2 and 3; in section 7, page 13, lines 9, 10, and 22; in section 14, page 24, line 19.

Section 2, page 3, lines 24 and 25, is so amended by the committee as to require that no Federal reserve bank shall "commence business" with a paid-up and unimpaired capital less in amount than $5,000,000, the original provision being that no Federal reserve bank should "be organized" with a paid-up and unimpaired capital less than $5,000,000. This alteration is considered desirable by reason of the fact that member banks are permitted to pay their stock subscriptions in two installments, covering a period of 60 days, and it is not deemed advisable to permit the Federal reserve banks to begin business until the total required subscriptions are paid, albeit they should be permitted to organize.

In section 3, page 4, line 12, the word "each" is inserted after "$100," and in lines 14 and 16 the word "stock" is inserted, to make it clear that the surplus of a bank is not comprehended in the use of the term "capital."

Section 4, page 4, beginning with line 24 and continuing to the word "Act," in line 9, page 5, is stricken out and the words in italics substituted in order to make plainer the method of organization prescribed for Federal reserve banks. The change in phraseology simply embodies the language of the statute relating to the organization of national banks and applies it to the organization of Federal reserve banks, whereas the provision originally simply made reference to the statute. In the same section, page 8, line 14, an amendment is inserted making provision for the contingency of a tie vote in balloting for Federal reserve bank directors of class A.

In section 5, page 12, line 17, an amendment is inserted requiring the Federal reserve board to prescribe regulations under which Federal reserve banks shall be required to make payment for surrendered shares of member banks which either reduce their capital stock or go into voluntary liquidation.

In section 10, page 17, line 22, and on page 18, line 1, and also in section 11, page 19, lines 15 and 16, and likewise in section 12, page 21, line 19, and on page 22, line 2, where the word "board" occurs the committee has altered the expression to "Federal reserve board" to make it more explicit.

In section 14, page 25, line 7, the semicolon after the word "Act" is stricken out and a comma substituted, and in line 9, after the word "securities," the comma is stricken out and a semicolon substituted, in order to make clearer the meaning of the provision.

In section 17, page 30, lines 9 and 10, an erroneous reference is corrected by striking out the words "and 15."

In section 20, page 37, line 16, and in the same section, page 38, line 16, the reserve requirement of 25 per cent within the 60-day period is dropped to 20 per cent in order to enable the reserve city and central reserve city banks the better to respond to the immediate demand upon them from the country banks in the first stage of shifting reserves. In short, instead of reducing the reserve requirement of the reserve city and central reserve city banks at the end of 60 days from the establishment of the Federal reserve bank, the reduction is made immediately after the Secretary of the Treasury shall have officially announced the organization of such bank. In the same section, page 38, lines 24 and 25, and on page 39, lines 1, 2, and 3, an alteration in phraseology is made so as to make the reserve requirement of central reserve city banks correspond exactly with the requirement of reserve city banks.

In section 26, page 44, lines 14 and 15, having reference to loans by national banks on farm lands, the words "or fifty per centum of its time deposits" are stricken out, for the reason that the committee thinks that the aggregate of such loans should be based on a bank's capital and surplus rather than on the constantly fluctuating per cent of time deposits.

NATURE AND PURPOSE OF H. R. 7837.

H. R. 7837 is intended to bring about necessary changes in the present banking and currency system of the United States and to correct long-standing evils that have had a slow and deep-rooting growth. It aims at the rectification of the essential defects of the present system, although it does not seek to make all the innovations that might, from an ideal standpoint, be deemed desirable.

DEMAND FOR ACTION.

There has for a great while been strong public demand for remedial legislation on banking and currency. This demand was partly obscured during the controversy regarding the adoption of a monetary standard. Yet even before the adoption of the act of March 14, 1900, there had been a vigorous popular movement directed to the amendment of the national banking act. This took form in various voluntary organizations and in actions by bankers' associations as well as by organizations of business and commercial interests. It was practically universally admitted from 1898 onward that one of the basic commercial evils of the day was the lack of a suitable banking system.

This view has been frequently reiterated and restated ever since the earlier days of the banking discussion to which reference has been made. Of late it has taken form in renewed agitation following the panic of 1907 and promises of action have been made in nearly every political platform, by whatever party adopted, within recent years. The call is loud and comes from many sources of widely divergent character.

It is probable that not a single scientific student of currency and banking could be found who would approve the conditions which now exist in the United States or the banking system under which they have sprung up. Nowhere in the world to-day can there be found a banking system similar or analogous to that of the United States, or a situation as to credit which could be compared to that prevailing in this country at the present moment.

REASONS FOR ACTION.

The considerations which thus dictate action upon the banking and currency question at the present time have often been stated and from many different points of view. In the opinion of the committee there can be no doubt whatever with regard to the essential elements of the case. The general background of the situation which calls for banking reform is this: Half a century ago Congress, in the midst of a civil war, established a new system subsequently developed into the national banking system. The essential elements in this system were three in number: (1) The maintenance of the principle of free banking through the unrestricted organization of banking institutions; (2) the refusal to allow the extension of systems of banking throughout the country by the organization of branch banks; and (3) the adoption of a peculiar system of note issue whereby the banks were required to buy a minimum of national bonds when chartered and subsequently to deposit with the Treasury bonds to protect all currency received by them for circulation. The different elements in this system will be fully considered at other points in the present report. It is enough now to suggest the general bearings of the case. This system has continued substantially unamended to the present time, and to-day includes some 7,473 banking institutions within its range. These banking institutions vary in size from $25,000 capital to $25,000,000. They are entirely local. The only bond between them is found either in mutual stock ownership or in the redepositing of reserves as they are permitted to do under the national-bank act. In view of the lack of any factor of unity the national banks have failed to furnish to the Nation as a whole a single and powerful system of credit. The strength of the credit situation in each community has depended upon the strength of the banks there situated, and, except in times of stress, has even in these communities been measured by the strength not of the strongest, but of the weakest institution there located. In times of stress the banks of such independent communities have at times in self-defense united to place their combined resources temporarily at the service of the public and of one another, but they have taken such action only under stern pressure. As a rule, they have been individualistic in the highest degree, and the country has lacked the capacity either to prevent credit disorders from breaking out locally and spreading to the centers, or to defend its own resources against the monetary demands of foreign nations or against the infection due to bad financial conditions in countries with which we stood in close relations.

The evidence that this system has not done its duty is not found in dishonesty or failure. While at times failures have been numerous among the national banks, as must necessarily be the case in any system of numerous and highly individualized banks, the average record of failure or irregularity has been small. No noteholder has ever lost a dollar, and the losses of depositors constitute in the aggregate a very small percentage of the total deposits held by the banks. The country has been enabled to do an expanding business, to its own great profit. But the evil of the situation has been perceived upon all those occasions when unusual pressure was brought to bear upon the banks of the country. In 1873, 1884, 1890, 1893, 1896, and 1907, to mention the most familiar occasions, it has been necessary for large groups of banks practically to suspend specie payments. They have done so as the result of concerted action, and one feature of the situation upon each of these occasions has been a genuine effort to relieve conditions by resorting to an issue of obligations for which the banks became jointly liable, and which in some measure helped to overcome shortage of currency and the stringency that was associated with it. In spite of all that could be done, however, the public has been put to great inconvenience and loss upon such occasions, the relations of the United States with foreign countries have been embarrassed, if not brought into jeopardy, the failure of firms, corporations, and individuals has been necessitated, and the loss of wealth has been tremendous. We think it is axiomatic that these conditions should not be allowed to repeat themselves, but that they should in some manner be relieved or prevented, if possible.

On the other hand, the national banking system, with its many merits, has not proved responsive to the seasonal needs of the community. At periods of exceptional demand for credit the movement of currency between various points, with attendant expense and delay, has been enormous, while the expansion of this currency has been slow and halting, local necessities being met by withdrawing circulating media from other regions. In consequence, the marketing of the country's annual crops has been slow, difficult, and expensive, and it has frequently happened that various sections of the Nation have been obliged to depend too largely upon the limited extension of credit to them by banks located elsewhere.

Conversely, it has been found that whenever the seasonal needs of credit in agricultural regions throughout the United States had been met and when the crops there produced had been fully disposed of there was an accumulation of currency, partly borrowed from other portions of the country, partly of local origin, which could not be used to advantage upon safe or sound security throughout the less active portions of the business year, and which was therefore shipped to banks in distant cities, that it might be there put to some employment that would yield its owners an income. It has not always turned out that the employment thus found for it was desirable or, on the whole, conducive to the good of the country.

NATURE OF EXISTING CONDITIONS.

Turning from the general considerations which tend to prevent the acceptance of existing banking conditions as satisfactory, there is need of a recognition of the immediate status of the financial and business world at the present day. There can be no doubt that for some time past the national banks of the United States have been in a difficult situation. The committee has been amply warned and advised of this state of things, and a general knowledge of it is common to the country at large, certainly to all close or careful observers of existing conditions. In the reserve centers to-day banks are unable to extend the credit that they would under normal circumstances be disposed to grant, while merchants are frequently unable to get the accommodation to which they are entitled. A general tendency toward stringency evidently exists, and while this is not peculiar to-day to the United States it should not be felt here in anything like its present severity, inasmuch as this country has not had to bear the burden of warfare and destruction of capital that has been thrown upon the European countries. All over the western world there is now a distinct shortage of capital, both fixed and floating, while our banking and reserve situation is anything but reassuring. Under such circumstances it is highly desirable that the utmost efficiency should be given to the reserve resources in the hands of the banks and that they should be enabled to do all that circumstances will permit in extending to the business world the volume of loans that it needs, so long as they maintain themselves in position to protect the accommodation thus granted. Legislation which will relieve this pending condition of pressure and possible panic, which will place the banks in position to employ their resources to the best advantage, which will obviate the necessity of expensive transfers of funds between different parts of the country, and which will furnish loans upon an inexpensive but absolutely safe basis was never more urgently demanded than it is to-day. It is this condition of affairs that has most strongly moved the Committee on Banking and Currency in its effort to press a measure of relief upon the attention of the House.

LACK OF PROTECTION AGAINST PANICS.

Reference has just been made to the fact that the national banking system, among other defects, fails to afford any safeguard against panics and commercial stringencies or any means of alleviating them. This fact has received more attention than has thus far been given to any other in the whole range of the banking and currency discussion, and there has been more effort to apply some legislative remedy to this than to any other condition.

In practice, when commercial credit had hopelessly broken down and the banks of the country found themselves seriously threatened by danger of failure, they have united for mutual protection, and clearing-house associations in the chief cities of the country have joined in the issue of certificates good in liquidating obligations between banks. Sporadic and temporary as this remedy has been, it nevertheless has proven effective while in use, and after the panic of 1907 an attempt was made to provide for a permanent resort to this so-called clearing-house currency by passing the act of May 30, 1908, ordinarily known as the Aldrich-Vreeland law. This law will expire automatically on June 30, 1914, inasmuch as the act itself carries a provision limiting its own life to six years. The fact that this legislation will thus expire is regarded by many persons as an additional argument for action at the present time, inasmuch as the measure in question constitutes the only emergency protection against conditions of sudden difficulty in the money market that the country now has. The Aldrich-Vreeland law provides for the establishment of organizations of banks, to be known as National Currency Associations, which are to be allowed to take out notes under certain conditions.

It is worth observing that up to date the Aldrich-Vreeland associations have been an entire dead letter. The situation regarding them was clearly sketched by the Comptroller of the Currency in his last annual report, in which he said:

> Under authority of the act of May 30, 1908, providing for the issue of "additional currency" secured otherwise than by United States bonds, 18 national currency associations have been formed, all of which, with the exception of the Los Angeles association, were formed prior to the current year. Each association has an aggregate capital and surplus of at least $5,000,000, and is composed of at least 10 national banks having an unimpaired capital and an unimpaired surplus of not less than 20 per cent of the capital, and having United States bonds on deposit to secure circulation to the extent of at least 40 per cent of its capital. There are 286 national banks forming these 18 national currency associations, their capital aggregating $321,105,710 and surplus $281,544,722. The capital represented is slightly in excess of 30 per cent of the paid-in capital stock of all national banks, as shown by the reports for September 4 last.

The title, membership, capital, and surplus of each of the associations are shown in the following table:

National currency associations.

Associations.	Number of banks.	Capital.	Surplus.
National Currency Association of Washington, D. C.	10	$5,702,000	$4,792,512
National Currency Association of the city of New York, N. Y.	33	117,052,000	127,175,000
National Currency Association of Philadelphia, Pa.	27	20,975,000	36,665,000
National Currency Association of the State of Louisiana	10	6,100,000	4,030,000
National Currency Association of Boston, Mass.	14	26,700,000	18,950,000
National Currency Association of Georgia	28	8,206,000	6,434,000
National Currency Association of Chicago	10	42,750,000	25,950,000
National Currency Association of St. Louis, Mo.	10	19,510,000	9,095,000
National Currency Association of St. Paul and Minneapolis	14	10,750,000	9,545,000
National Currency Association of Detroit	15	6,325,000	3,101,200
National Currency Association of Albany, etc.	11	3,560,000	3,385,000
National Currency Association of Kansas City, etc.	10	6,659,000	3,800,000
National Currency Association of Baltimore	18	12,340,710	7,752,010
National Currency Association of Cincinnati	10	14,300,000	6,450,000
National Currency Association of Dallas	14	3,760,000	3,100,000
National Currency Association of Alabama	25	5,700,000	3,497,500
National Currency Association of Denver, etc.	15	4,700,000	4,991,500
National Currency Association of Los Angeles	12	6,025,000	2,831,000
Total	286	321,105,710	281,544,722

In accordance with the terms of the Aldrich-Vreeland Act, $500,000,000 in currency has been printed and is now ready, in blank, for issue in case of a call from any of the banks or currency associations authorized to issue notes by the terms of the law. Individual banks may issue such notes by depositing at the Treasury State or municipal bonds of approved kinds, receiving in exchange 90 per cent of the par value of such bonds, provided they are worth at least par. The currency associations may obtain notes equal to 75 per cent of the face value of commercial paper left with them by the constituent banks of the association.

One reason why the Aldrich-Vreeland law has never been availed of is that the issue of the currency was made very expensive, owing to the imposition of a heavy tax on such notes as might be taken out, while the banks were for a long time reluctant to go into the currency associations because of the onerous conditions under which they were at first required to be authorized by the terms of the regulations laid down by the Secretary of the Treasury. The law is thus not likely to be resorted to except in cases of very severe necessity for notes; but, even if such were not the case, it would remain a temporary expedient and a mere extension of its life would be only the renewal of such an expedient.

No statement could make clearer the inadequate character of the Aldrich-Vreeland Act or its purely temporary character. It is a weak makeshift, soon to expire.

RECOGNITION OF SITUATION.

That under the conditions just sketched there is a responsibility resting upon those in charge of the Government of the United States no one can deny. No more serious obligation to-day exists in the whole range of national problems. This duty has been amply recognized by the Democratic Party. In platform after platform it has stood firmly for the adoption of sound and courageous legislation, and at Baltimore in 1912 it adopted without dissent the following plank:

We oppose the so-called Aldrich bill for the establishment of a central bank; and we believe our country will be largely freed from panics, and consequent unemployment and business depression, by such a systematic revision of our banking laws as will render temporary relief in localities where such relief is needed, with protection from control or domination by what is known as the Money Trust.

Banks exist for the accommodation of the public and not for the control of business. All legislation on the subject of banking and currency should have for its purpose the securing of these accommodations on terms of absolute security to the public and of complete protection from the misuse of the power that wealth gives to those who possess it.

That this plank constitutes a direct claim upon the party, challenging its immediate attention, is the opinion of the Banking and Currency Committee. The claim is the more urgent because there has been a most lamentable failure to face the banking situation fairly in past legislation.

PREPARATIONS FOR WORK.

Believing that there would be a Democratic victory at the polls and fully appreciating the obligations to follow therefrom, the Banking and Currency Committee of the Sixty-second Congress had already begun preparations looking to the redemption of party pledges, past and present. In that Congress a subcommittee of the Banking and Currency Committee was directed to begin a study of the question of reform legislation. This subcommittee conducted preliminary inquiries during the summer and autumn of 1912, and having thus marked out the lines of necessary work undertook hearings during January and February, 1913, for the purpose of obtaining the views of qualified members of the community with regard to what ought to be done. The subcommittee extended invitations at that time to representatives of labor organizations, to agricultural associations, to the bankers of the country, to voluntary associations of citizens interested in questions of banking, money, and credit, and to individuals recognized as being expert students of monetary and credit conditions. While some of those who received invitations to appear before the subcommittee failed to accept, the majority did so, and practically all the essential phases of the situation were thoroughly canvassed. Besides holding these hearings, the committee sent to many economists, bankers, and expert persons questions bearing upon the currency and banking problem and received responses giving the views of those who were thus appealed to. H. R. 7837 was drafted as the result of these investigations and thus represents, all told, the results of approximately 16 months' work.

The Banking and Currency Committee as at present organized held its first meeting on June 6, 1913, and since that date the committee has devoted almost continuous work to the discussion of the bill. The outcome of its deliberations has been to approve the essential features of the bill H. R. 7837, with some modifications which are embodied in the measure as now reported.

WORK OF MONETARY COMMISSION.

The committee, in undertaking to prepare for banking and currency legislation, has first of all endeavored to take into account all existing data and to examine such preliminary work as had neen made available. The most recent collection of such material available is that prepared under the auspices of the National Monetary Commission. While the Republican Party refused to take any affirmative action, except the act of May 30, 1908, it did undertake what was called an investigation of monetary and banking conditions. The act of

May 30, 1908, known as the Aldrich-Vreeland Act, already referred to, provided for the appointment of a body known as the National Monetary Commission, in the following language:

APPOINTMENT OF MONETARY COMMISSION.

SEC. 17. That a commission is hereby created, to be called the "National Monetary Commission," to be composed of nine members of the Senate, to be appointed by the Presiding Officer thereof, and nine Members of the House of Representatives, to be appointed by the Speaker thereof; and any vacancy on the commission shall be filled in the same manner as the original appointment.

POWERS OF COMMISSION—COMMISSION TO REPORT TO CONGRESS.

SEC. 18. That it shall be the duty of this commission to inquire into and report to Congress at the earliest date practicable what changes are necessary or desirable in the monetary system of the United States or in the laws relating to banking and currency, and for this purpose they are authorized to sit during the sessions or recess of Congress, at such times and places as they may deem desirable, to send for persons and papers, to administer oaths, to summons and compel the attendance of witnesses, and to employ a disbursing officer and such secretaries, experts, stenographers, messengers, and other assistants as shall be necessary to carry out the purposes for which said commission was created. The commission shall have the power, through subcommittee or otherwise, to examine witnesses and to make such investigations and examinations in this or other countries of the subjects committed to their charge as they shall deem necessary.

EXPENSES OF COMMISSION.

SEC. 19. That a sum sufficient to carry out the purposes of sections seventeen and eighteen of this act, and to pay the necessary expenses of the commission and its members, is hereby appropriated, out of any money in the Treasury not otherwise appropriated. Said appropriation shall be immediately available and shall be paid out on the audit and order of the chairman or acting chairman of said commission, which audit and order shall be conclusive and binding upon all departments as to the correctness of the accounts of such commission.

WHEN ACT EXPIRES BY LIMITATION.

SEC. 20. That this act shall expire by limitation on the thirtieth day of June, nineteen hundred and fourteen.

This commission was immediately organized and continued to do sporadic work until March, 1912, when it was dissolved by virtue of an act of Congress passed in the preceding August, just before the close of the special session of Congress summoned by President Taft for the discussion of the reciprocity question. Persons employed by the National Monetary Commission prepared a large series of books on various historical and current phases of the banking question, but the only significant feature of its work is found in a bill drafted under the auspices of the commission and finally laid before Congress with a brief accompanying report giving the reasons for the measure. This measure was at once introduced into Congress by Senator Theodore E. Burton, himself a member of the commission, and was referred to the Senate Finance Committee, but never received official consideration.

The monetary commission provided for as just described spent a large sum of money in costly travels, including journeys to Europe and outlays for printing. In answer to a request for information made by the Senate in 1911, Secretary MacVeagh, then in charge of the Treasury Department, sent to the House a letter in which he fixed the cost of the commission to May 12, 1911, at $207,130.

VALUE OF COMMISSION'S WORK.

The work done at such great cost should not, indeed can not, be ignored, but, having examined the extensive literature published by the commission, the Banking and Currency Committee finds little bearing upon the present state of things in the credit market of the United States. Most of the matter published by the commission is a revision or recasting of books and documents having only historical value or brought down to modern times by their authors or others. There is practically nothing of original value or of direct aid bearing upon the details of remedial legislation.

The bill favored by the commission and popularly known as the Aldrich bill, from the name of the chairman of the monetary commission, ex-Senator Nelson W. Aldrich, of Rhode Island, remains as the chief distinct trace of the commission's existence. It has not commended itself to the Banking and Currency Committee. The Aldrich bill is a lengthy and elaborate statute and no sufficient account of its contents or of the reasons for refusing to accept it can be given in brief space. Something, however, may be said of it. This bill has often been spoken of as a poisonous theoretical novelty and at other times as an ingenious scheme to create a central bank which would absorb all banking functions to itself. In fact it was neither of these things. Little of novel character is found in the ideas underlying the Aldrich bill. To mention only two of the many proposals embodying the same general ideas as those held by the framers of the Aldrich bill, the plans for banking and currency legislation suggested by Hon. Charles N. Fowler in his "A financial and banking system for the United States" (H. R. 23707, 60th Cong., 1st Sess.), and by Hon. Maurice L. Muhleman, in his "Plan for a central bank," reprinted from the Banking Law Journal, have the same purpose in view. They differ in several important details, none of which, however, is absolutely fundamental to the scheme presented.

The objects technically aimed at in all these measures were desirable and the criticism to be made of the Aldrich bill does not, in the opinion of the committee, reside in its confessed purposes, but in the methods by which it undertook to carry them out and the disregard of public welfare by which it was characterized.

The Aldrich bill was not a plan for a central bank as that term is properly used. It called for the creation of a national reserve association which was to do business only with banks, while the Government had but little power over the institution and the public neither business nor other relations with it. Without going further into the detailed analysis of the Aldrich bill it may be stated that the committee objects to the plan fundamentally on the following points:

1. Its entire lack of adequate governmental or public control of the banking mechanism it sets up.

2. Its tendency to throw voting control into the hands of the larger banks of the system.

3. The lack of adequate provision for protecting the interests of small banks and the tendency to make the proposed institution subserve the purposes of large interests only.

4. The intricate system by which the reserve institution it created was prevented from doing any business that might compete with that of existing banks.

5. The extreme danger of inflation of currency inherent in the scheme.
6. The clumsiness of the whole mechanism provided by the measure.
7. The insincerity of the bond-refunding plan provided for by it, there being a barefaced pretense that this system was to cost the Government nothing.
8. The dangerous monopolistic aspects of the bill.

ESSENTIAL FEATURES OF REFORM.

The other plans before the committee or examined by it have likewise been found unsatisfactory—some for reasons analogous to those which made the Aldrich bill unacceptable, others because of defective detail, erroneous principle, or faulty construction. An effort was, however, made to ascertain the constituent elements of these measures and of the Aldrich bill, common to all, which should be recognized and provided for in any new plan because representing the fundamentals of legislation. It is believed that these are as follows:

1. Establishment of a more nearly uniform rate of discount throughout the United States, and thereby the furnishing of a certain kind of preventive against overexpansion of credit which should be similar in all parts of the country.
2. General economy of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments, as so often in the past.
3. 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 which should be available to all institutions which had the proper class of paper for presentation.
4. Management and commercial use of the funds of the Government which are now isolated in the Treasury and subtreasuries in large amounts.
5. General supervision of the banking business and furnishing of stringent and careful oversight.
6. Creation of market for commercial paper.

Other objects are sought, incidentally, in these plans, but they are not as basic as the chief purposes thus enumerated.

The first problem in developing a measure was, of course, the consideration of various alternative courses which might be pursued.

CENTRAL BANK QUESTION.

At the outset of the committee's work it was met by a well-defined sentiment in favor of a central bank. This idea appeared to have become rooted with a large section of the banking community, and was the manifest outgrowth of the work that had been done by the National Monetary Commission, and those who believed that the recommendations of that body were well founded. While the institution which would have been created by the National Monetary Commission bill was not a central bank in the technical sense of the term, inasmuch as it did not do a general banking business, it was a central bank in many of the aspects that are usually regarded as characteristic of that term. The idea of the monetary commission bill had been accepted with great fervor by those who believed that the use of a centralization principle was necessary, as well as by others who deemed that their own objects would be served by the particular form that had been given to the proposal of the monetary commission in its bill.

Without allowing itself to entertain any prepossessions either for or against the central bank idea, the committee carefully examined this notion both at hearings and through private study. It reached in general the following conclusions:

1. The idea of centralization or cooperation, or combined use of banking resources, is the basic idea at the root of central banking argument.

2. It is not necessary in order to obtain the benefits of the application of this idea that there should be one single central bank whose activities should be coterminous with the limits of a nation's territory.

3. Equally good results can be obtained by the federating of existing banks and banking institutions in groups sufficiently large to afford the strength or cooperating power which is the chief advantage of the centralization.

4. In the United States, with its immense area, numerous natural divisions, still more numerous competing divisions, and abundant outlets to foreign countries, there is no argument either of banking theory or of expediency which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled, or how patriotically conducted.

5. It is therefore necessary to abandon the idea of a single central banking mechanism for the United States unless it shall be found that there are considerations of expediency which would dictate a resort to this policy.

6. For reasons which will be stated at a later point the conviction was formed not only that there are no such reasons of expediency, but that every consideration of that character would lead to action of an opposite nature.

It was therefore decided that throughout its efforts to formulate a banking measure there should be no necessary attempt to base the result of the bill upon the central banking idea. Only in so far as that idea indicated an easy and natural adjustment to existing institutions and conditions was it to be given a place in the ultimate findings.

BRANCH BANKING SYSTEM.

Many bills have been introduced into Congress from time to time for the establishment of branches of existing national banks, and the system has so widespread and respectable a support as to make it apparent from the outset that this aspect of banking theory and practice should be considered. The eminent success of the Canadian banking system and of others similar to it enforces upon the most indifferent student of the subject the significance of branch banking as a means of securing cooperation and the junction of resources in support of any weak element in a banking system that may have been subjected to attack at a given moment. It is clear that Canada, for example, with her 27 banks and thousands of branch banks, represents a distinctly different type of banking from that which is exemplified by the national banking system with its 7,473 independent banks, none of which possesses a single branch formed under the national banking act. The question was thus clearly to be considered whether the bestowal of the branch power would in fact meet the difficulties of the present situation in the United States. Careful study of the applicability of the Canadian banking system to American conditions convinced the committee that an adaptation of it would not be feasible to-day. The successful introduction of the branch system would almost necessarily have meant the abandonment of the idea of free banking. While it would not necessarily have been requisite to abandon free banking in theory in order to introduce the Canadian principle, it would have been practically true that the power of establishing branch banks, if widely exercised by large national institutions, would have entailed the contracting of the number of independent banks in the United States and a corresponding limitation of the perfect freedom of competition which exists to-day. Certainly it would not have been possible to introduce the principles of the Canadian system into American banking without a very extensive and vital modification of banking legislation and conditions in the United States. That the country was prepared for so profound a modification, not to say transformation, of the basic ideas upon which the national banking system has been developed the committee did not believe and it was therefore led to the abandonment of all thought of attempting a plan of banking reform based upon the conception of large privately managed institutions operating unrestrictedly and with great numbers of branches. This conclusion did not, of course, imply any belief that the adoption of other features of the Canadian system which seemed applicable and could be easily grafted upon our own system was undesirable. It was a conclusion relating simply to one of the general ideas underlying the structure of Canadian banking.

QUESTION OF NOTE ISSUES.

Very early in its inquiries the committee was necessarily confronted with the question whether a mere reconstruction of the note-issue system of the United States would suffice to furnish the basis for banking reform. Ten years ago and earlier, the dominant note in banking reform literature seemed to be that of elasticity in currency, and it was frequently urged by men of widely different political beliefs and of totally varying views as to the theory of money and banking that the whole problem was essentially a matter of currency issue. The bankers who urged the creation of an asset currency and the public men who recommended the issuance of additional United States notes or Treasury notes, whether protected or unprotected, were fundamentally alike in their belief that the whole trouble with existing banking lay in a difficulty in securing proper supplies of currency when needed and of withdrawing them when not needed.

A careful study of this phase of banking discussion convinced the committee most unmistakably that those who would regard the banking and credit problem as soluble through the proper treatment of the paper currency question solely were accepting a superficial view of the real elements of the difficulty. As is well known, the bank extends its credit in two forms, either (1) by the granting of a book credit or "deposit" or (2) by the issuing of notes. There is no essential difference between these two forms of credit, if they are protected by similar reserve funds, except that they are likely to have a different term of existence, the deposit credit being ordinarily redeemed much more rapidly and efficiently than even the most elastic note issues. To provide therefore for a free issue of note currency, whether by the Government or by the banks, would not meet the need for a more effective supply of deposit credits. In times of stress the difficulty under which banks labor is not usually that of lack of assets, but is that of inability to convert good assets into a medium that can be used in making payments. However desirable it might be to be able to turn sound and liquid commercial assets into a note currency payable to anyone willing to receive it, and however desirable it might be to obtain a free issue of Government legal-tender notes obtainable by any individual who might possess property of specified classes, such notes would plainly not meet the needs of those who desired the book form of credit. While they might indeed be converted into book credit by depositing them with the banks, such a course would have entailed many incidental consequences that should not have been made prerequisite to the obtaining of means of payment. It was felt therefore that a return to the older conception of banking reform as being primarily a problem of securing easily expansible supplies of notes would not meet the needs of the situation to-day, and even though it should prove to be of some temporary value in times of special stress would not constitute that permanent and reliable support to business credit that was sought. It was therefore concluded that while a proper issue of note currency should necessarily be included as a feature in any measure to be recommended it could not be taken as the sole or even the primary purpose of such legislation.

CLEARING-HOUSE ORGANIZATION.

Another type of plan that has been frequently urged by students of banking conditions in the United States is that of clearing-house organization. It has been suggested that inasmuch as the clearing-house associations of the country represent a kind of voluntary association among bankers—one, too, that has already been frequently and successfully availed of in time of stress—it would be well worth while to endeavor to base such new organization as might be favored upon the clearing houses of the country. Various plans for this purpose have been worked out with more or less success. The Aldrich-Vreeland law, already frequently referred to, was a partial application of this idea although before the act was finally adopted it had become necessary to modify in very great degree the original clearing-house principles upon which the plan was in the first instance founded. Most such plans have proceeded upon the theory that it was entirely feasible to compel banks to join national clearing-house associations which should be incorporated and over which the Government should exercise a measure of control. To these incorporated clearing houses, it has been suggested, could be committed the function of issuing "emergency currency" based upon the joint assets of the banks, thus providing for regular and authorized employment of the method of credit extension which has been made use of in times past when stringent conditions had developed themselves in the banking community. It has not been deemed wise upon examination to attempt any device of this sort. If the clearing houses as thus recognized and authorized perform their functions of credit extension only occasionally and sporadically they remain an emergency expedient. The committee is convinced that what is needed is not a means of remedying emergencies after they have arisen but a plan for guarding against the development of such emergencies and for so protecting the community that it will not be under the necessity of calling for the use of abnormal devices in its interest. If the clearing-house associations referred to should be organized upon a permanent basis with a view to making such extensions of credit as a regular and normal incident of business, they would not in any material respect differ from banking institutions. The retention of the name "clearing houses" would then be misleading and could not be defended. From no point of view, therefore, has the plan suggested commended itself. This does not signify that the idea of cooperative effort embodied in the clearing-house plan is unsatisfactory, but, as will be seen later, quite the contrary. It does mean that the use of existing clearing-house machinery for the purpose of granting accommodation under exceptional conditions does not seem to the committee to be a wise method of providing the credit resources that are needed in affecting a thorough reform of the banking and currency system of the country.

OTHER PLANS INADEQUATE.

Of the multitude of other plans, some beyond the confines of reasonableness, others more or less conforming to actual necessities and to legitimate principles of banking and currency legislation, nothing needs be said except that none has been found which, in the opinion of the committee, is at the same time feasible, available, trustworthy, and sufficiently inclusive to afford a thorough basis of reform of the present conditions. The committee does not feel that the legislation now to be adopted should seek to include within its scope all the possible features upon which action is required, but rather that it should attempt to lay a foundation for future development by selecting those elements in the situation that are most in need of attention and seeking to deal thoroughly with the problems offered in this more restricted field of action. It has therefore put aside many schemes of reform which, however desirable they might abstractly be, do not conform to the standards already outlined. It has limited itself to the fundamental necessities of the present situation as it views them and has sought to keep its recommendations within narrow scope in order that no extraneous issues might become involved with the general problem which lies at the base of further improvement. It has deferred the thorough reform of the national-bank act on its administrative side, and it has determined to postpone, in like manner, the question of long-term agricultural credit, firmly believing that neither of these subjects can be adequately dealt with until the substructure of banking organization has been remodeled.

FUNDAMENTAL FEATURES OF REFORM.

After looking over the whole ground, and after examining the various suggestions for legislation, some of which have just been outlined, the Committee on Banking and Currency is firmly of the opinion that any effective legislation on banking must include the following fundamental elements, which it considers indispensable in any measure likely to prove satisfactory to the country:

1. Creation of a joint mechanism for the extension of credit to banks which possess sound assets and which desire to liquidate them for the purpose of meeting legitimate commercial, agricultural, and industrial demands on the part of their clientele.
2. Ultimate retirement of the present bond-secured currency, with suitable provision for the fulfillment of Government obligations to bondholders, coupled with the creation of a satisfactory flexible currency to take its place.
3. Provision for better extension of American banking facilities in foreign countries to the end that our trade abroad may be enlarged and that American business men in foreign countries may obtain the accommodations they require in the conduct of their operations.

Beyond these cardinal and simple propositions the committee has not deemed it wise at this time to make any recommendations, save that in a few particulars it has suggested the amendment of existing provisions in the national-bank act, with a view to strengthening that measure at points where experience has shown the necessity of alteration.

PROPOSED PLAN.

In order to meet the requirements thus sketched, the committee proposes a plan for the organization of reserve or rediscount institutions to which it assigns the name "Federal reserve banks." It recommends that these be established in suitable places throughout the country to the number of 12 as a beginning, and that they be assigned the function of bankers' banks. Under the committee's plan these banks would be organized by existing banks, both National and State, as stockholders. It believes that banking institutions which desire to be known by the name "national" should be required, and can well afford, to take upon themselves the responsibilities involved in joint or federated organization. It recommends that these bankers' banks shall be given a definite capital, to be subscribed and paid by their constituent member banks which hold their shares, and that they shall do business only with the banks aforesaid, and with the Government. Public funds, it recommends, shall be deposited in these new banks which shall thus acquire an essentially public character, and shall be subject to the control and oversight which is a necessary concomitant of such a character. In order that these banks may be effectively inspected, and in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole, the committee proposes a general board of management intrusted with the power to overlook and direct the general functions of the banks referred to. To this it assigns the title of "The Federal reserve board." It further recommends that the the present national banks shall have their bonds now held as security for circulation paid at the end of 20 years, and that in the meantime they may turn in these bonds by a gradual process, receiving in exchange 3 percent bonds without the circulation privilege.

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," to be the obligations of the United States, but to be paid out solely through Federal reserve banks upon the application of the latter, protected by commercial paper, and with redemption assured through the holding of a reserve of gold amounting to 33⅓ per cent of the notes outstanding at any one time. In order to meet the requirements of foreign trade, the committee recommends that the power to establish foreign branch banks shall be bestowed upon existing national banks under carefully prescribed conditions and that Federal reserve banks shall also be authorized to establish offices abroad for the conduct of their own business and for the purpose of facilitating the fiscal operations of the United States Government. Finally and lastly, the committee suggests the amendment of the national-bank act in respect to two or three essential particulars, the chief of which are bank examinations, the present conditions under which loans are made to farming interests, and the liability of stockholders of failed banks. It believes that these recommendations, if carried out, will afford the basis for the complete reconstruction and the very great strengthening and improvement of the present banking and credit system of the United States. The chief evils of which complaint has been made will be rectified, while others will at least be palliated and put in the way of later elimination.

FEDERAL RESERVE BANKS.

The Federal reserve banks suggested by the committee as just indicated would be in effect cooperative institutions, carried on for the benefit of the community and of the banks themselves by the banks acting as stockholders therein. It is proposed that they shall have an active capital equal to 10 per cent of the capital of existing banks which may take stock in the new enterprise. This would result in a capital of something over $100,000,000 for the reserve banks taken together if practically all existing national banks should enter the system. It is supposed, for a number of reasons, that the banks would so enter the system. More will be said on this point later in the discussion. How many State banks would apply for and be granted admission to the new system as stockholders in the reserve banks can not be confidently predicted. It may, however, be fair to assume at this point that the total capital of the reserve banks will be in the neighborhood of $100,000,000. The bill recommended by the committee provides for the transfer of the present funds of the Government included in what is known as the general fund to the new Federal reserve banks, which are thereafter to act as fiscal agents of the Government. The total amount of funds which would thus be transferred can not now be predicted with absolute accuracy, but the released balance in the general fund of the Treasury is not far from $135,000,000. Certain other funds now held in the department would in the course of time be transferred to the banks in this same way, and that would result in placing, according to the estimates of good authorities, an ultimate sum of from $200,000,000 to $250,000,000 in the hands of the reserve banks. If the former amount be assumed to be correct, it is seen that the reserve banks would start shortly after their organization with a cash resource of at least $300,000,000. As will presently be seen in greater detail, it is proposed to give to the reserve banks reserves now held by individual banks as reserve holders under the national banking act for other banks. Confining attention to the national system, it is probable that the transfer of funds thus to be made by the end of a year from the date at which the new system would be organized would be in the neighborhood of $350,000,000. If State banks entered the system and conformed to the same reserve requirements they would proportionately increase this amount, but for the sake of conservatism the discussion may be properly confined to the national banks. For reasons which will be stated at a later point, it seems likely that at least $250,000,000 of the reserves just referred to would be transferred to the reserve banks in cash; and if this were done the total amount of funds which they would have in hand would be at least $550,000,000. This would create a reservoir of liquid funds far surpassing anything of similar kind ever available in this country heretofore. It would compare favorably with the resources possessed by Government banking institutions abroad.

It will be observed that in what has just been said the reserve banks have been spoken of as if they were a unit. The committee, however, recommends that they shall be individually organized and individually controlled, each holding the fluid funds of the region in which it is organized and each ordinarily dependent upon no other part of the country for assistance. The only factor of centralization which has been provided in the committee's plan is found in the Federal reserve board, which is to be a strictly Government organization created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself. Careful study of the elements of the problem has convinced the committee that every element of advantage found to exist in cooperative or central banks abroad can be realized by the degree of cooperation which will be secured through the reserve-bank plan recommended, while many dangers and possibilities of undue control of the resources of one section by another will be avoided. Local control of banking, local application of resources to necessities, combined with Federal supervision, and limited by Federal authority to compel the joint application of bank resources to the relief of dangerous or stringent conditions in any locality are the characteristic features of the plan as now put forward. The limitation of business which is proposed in the sections governing rediscounts, and the maintenance of all operations upon a footing of relatively short time will keep the assets of the proposed institutions in a strictly fluid and available condition, and will insure the presence of the means of accommodation when banks apply for loans to enable them to extend to their clients larger degrees of assistance in business. It is proposed that the Government shall retain a sufficient power over the reserve banks to enable it to exercise a directing authority when necessary to do so, but that it shall in no way attempt to carry on through its own mechanism the routine operations of banking which require detailed knowledge of local and individual credit and which determine the actual use of the funds of the community in any given instance. In other words, the reserve-bank plan retains to the Government power over the exercise of the broader banking functions, while it leaves to individuals and privately owned institutions the actual direction of routine.

TRANSFER OF RESERVES.

Reference has been briefly made to the fact that the committee's proposals provide for the transfer of bank reserves from existing banks which hold them for others to the proposed reserve banks. At present the national banking act recognizes three systems of reserves:

(1) Those in central reserve cities, where banks are required to hold 25 per cent of their deposit liabilities in actual cash in the vaults, while banks situated outside of such cities are allowed to make certain deposits with them which shall count as a part of the reserves of such outside banks.

(2) Those in reserve cities, 47 in number, which are required to keep a nominal reserve of 25 per cent, 12½ per cent of this being in cash in their own vaults, while 12½ per cent may consist of deposits with banks in central reserve cities.

(3) Those in the "country," by which is meant all places outside of central reserve and reserve cities, it being required that such banks shall nominally keep 15 per cent of their deposit liabilities, of which 6 per cent is held in cash in their vaults and 9 per cent may be held in the form of balances with other banks in reserve and central reserve cities.

The original reason for creating this so-called "pyramidal" system of reserves was that inasmuch as central banking institutions were absent, and inasmuch as banks outside of centers were obliged to keep exchange funds on deposit with other banks in such centers, it was fair to allow exchange balances with such centrally located banks to count as reserves inasmuch as they were presumably at all times available in cash. This is an absolutely anomalous and unique system, found nowhere outside of the United States, and dangerous in proportion as the number of the reserve centers thus recognized increases beyond a prudent number. The law has almost necessarily been liberal in recognizing the power to increase the number of such centers, with the result that whereas but few existed just after the organization of the national bank act, there being then 3 central reserve and 13 reserve cities, there are to-day 3 central reserve and 47 reserve cities. Even had this extension of the number of centers not occurred, the system established under the national banking act would still have been unsatisfactory. As matters have developed, it has been vicious in the extreme. Coupled with the inelasticity of the bank currency, the system has tended to create periodical stringencies and periodical plethoras of funds. Banks in the country districts unable to withdraw notes and contract credit when they have seen fit to do so, because of the rigidity of the bond-secured currency, have redeposited such funds with other banks in reserve and central reserve cities and have thus built up the balances which they were entitled to keep there as a part of their reserves.

Moreover, the practice of thus redepositing funds having been once established, it has been carried to extreme lengths, and at times has been decidedly injurious in its influence. The payment of interest on deposits by banks in the centers has been used for the purpose of attracting to such banks funds which otherwise would have gone to other centers or to other banks in the same centers or which would have been retained at home. The funds thus redeposited, even when not attracted by any artificial means, have of course constituted a demand liability, and have been so regarded by the banks to which they were intrusted.

In consequence, such banks have sought to find the most profitable means of employment for their resources and at the same time to have them in such condition as would permit their prompt realization when demanded by the depositing banks which put them there. The result has been an effort on the part of the national banks, particularly in central reserve cities, to dispose of a substantial portion of their funds in call loans protected by stock-exchange collateral as a rule. This was on the theory that, inasmuch as listed stock-exchange securities could be readily sold, call loans of this type were for practical purposes equivalent to cash in hand. The theory is of course close enough to the facts when an effort to realize is made by only one or few banks, but is entirely erroneous whenever the attempt to withdraw deposits is made by a number of banks simultaneously. At such times, the banks in central reserve and reserve cities are wholly unable to meet the demands that are brought to bear on them by country banks; and the latter, realizing the difficulties of the case, seek to protect themselves by an unnecessary accumulation of cash which they draw from their correspondents, thereby weakening the latter and frequently strengthening themselves to an undue degree. Under such circumstances the reserves of the country, which ought to constitute a readily available homogeneous fund, ready for use in any direction where sudden necessities may develop, are in fact scattered and entirely lose their efficiency and strength owing to their being diffused through a great number of institutions in relatively small amount and thereby rendered nearly unavailable. This evil has been met in times past by the suspension of specie payments by banks and by the substitution of unauthorized and extra-legal substitutes for currency in the form of cashiers' checks, clearing-house certificates and other methods of furnishing a medium of exchange. Needless to say such a method of meeting the evil is the worst kind of makeshift and is only somewhat better than actual disaster.

HOLDING OF FUNDS.

The committee believes that the only way to correct this condition of affairs is to provide for the holding of reserves by duly qualified institutions which shall act primarily in the public interest and whose motives and conduct shall be so absolutely well known and above suspicion as to inspire unquestioning confidence on the part of the community. It believes that the reserve banks which it proposes to provide for will afford such a type of institutions and that they may be made the effective means for the holding of the liquid reserve funds of the country to the extent that the latter are not needed in the vaults of the banks themselves. To meet this end it proposes that every bank which shall become a stockholder in the new reserve banks shall place with the Federal reserve bank of its district a portion of its own reserve equal ultimately to 5 per cent of its demand deposits. Country banks would be required to keep 5 per cent in their own vaults, while the remaining 2 of a required total of 12 per cent might be at home or in the reserve bank of the district. In the case of reserve and central reserve cities the committee has felt that the change in their position as reserve-holding banks acting for other banks called for a corresponding change in the cash to be held by these banks. It has therefore reduced the gross reserve requirements from 25 to 18 per cent of deposits and the cash in vault requirement from 25 per cent in the central reserve cities to 9 per cent and from 12½ per cent in the reserve cities to 9. This places the two classes of reserve cities on an equal basis, leaves each ultimately with 9 per cent cash, requires each to keep 5 per cent in the reserve bank of the district, and permits each to keep a final 2 or 4 per cent either there or in its own vaults.

A period of three years is granted during which the deposits of country banks may be kept with the present correspondent banks in order that the latter may not be unduly embarrassed by sudden withdrawals while the new reserve banks will not be as suddenly compelled to provide for using a very large quantity of funds. The committee is aware that the step thus recommended is of fundamental importance and will produce an extensive transformation in present methods of national banking. It, however, believes that the effects of this transformation will be altogether beneficial and is confident that the conditions under which the change is to take place as provided in the new bill are such as to make the transfer not only without suffering to the banks but under conditions that will actually enable them to extend further loans to the community. The actual effects of the operation proposed have been worked out in some detail by the committee and are presented as a series of computations in connection with the section of the proposed bill which provides for the revision of reserve requirements. Final analysis of these figures may be deferred until that point. It is enough to say at this point that a sufficient amount of reserve has been released, as compared with present requirements, amply to provide for the actual transfer of funds called for by the bill at the outset of the new system. Subsequent transfers will amount only to about enough to place the new system upon the same basis as the old in the matter of reserve requirements, when a margin has been allowed for contributions of capital and for possible accessions of State banks to the system. Or, to sum up, the new system will require less cash than the present one in order to fulfill its reserve requirements and provide for the payment of capital subscriptions. The margin between present and proposed requirements which it is thought should be left in order that State banks may come into the system without causing any strain upon the cash resources of the country will probably be from $100,000,000 to $150,000,000, a sum which is believed to be ample. Needless to say the new reserve requirements will not fall upon all banks in precisely the same way or with precisely the same degree of severity. In the case of some it may be that a transfer of cash to the new system will be undesirable. In such an event it is, of course, always open to the banks to establish their required reserve credit with the new Federal reserve banks by rediscounting paper with them. With the enormous resources that will belong to these reserve banks at the outset they will be amply able to take care of many times the amount of any such applications that are likely to be made to them.

RETIREMENT OF BOND-SECURED CURRENCY.

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 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-security plan and the introduction of something else in its place.

DIFFICULTY OF BOND HOLDINGS.

The first difficulty in passing from the bond-secured system of note issues to anything that might be devised to take its place is the fact that even if all had been satisfactorily arranged with reference to the new system, its soundness, etc., the difficulty of dealing with the bonds would remain. The act of March 14, 1900, provided for refunding the outstanding bonds into the 2 per cent consolidated debt and these 2 per cent bonds were subsequently sold at premiums which once ran as high as 8 or 9 per cent and have regularly been 2 or 3 per cent or more. Primarily as a result of general depreciation in the values of bonds due to rising prices and higher interest for capital, the national bond quotations have sunk until the 2 per cents are now below par. The ownership of bonds has thus inflicted a severe loss upon holders already, and something like $30,000,000 has, according to the Comptroller of the Currency, been "written off" by the banks and must be regarded as one of the costs of carrying the note system at present in use. There is general agreement that if the circulation privilege were to be taken from t' e 2 per cent bonds or, what is the same thing, if a new system of note issue were to be established which would practically displace the present system, the twos would deteriorate to a price not higher than 80. This would mean a shrinkage of one-fifth of the par value of the bonds and would inflict upon the banks an aggregate loss of nearly $150,000,000. Alternative to this is the idea of providing for a refunding of the bonds. Experience, as well as computations made in the Treasury, indicate that 3 per cent is now about the level of the Government's present borrowing power. The $50,000,000 Panama bonds last sold brought a premium of between 2 and 3 per cent, but 3 per cent interest without the circulation privilege represents the minimum interest that must be paid (in round numbers) upon any future issue which is to be floated upon an investment basis. In order to safeguard the banks against loss, therefore, a plan of refunding into 3 per cent bonds would have to be followed. The banks might be offered cash payment for their bonds at par, and the new securities might be sold for what they would bring, or an exchange of 3 per cents for the old twos might be ordered. The latter would be simpler, and the former would probably cost a little more. Either plan would entail an increase in the present interest burden nearly amounting to 1 per cent annually on at least $740,000,000, or $7,400,000 a year.

Temporary alternatives for the retirement of the bonds are, however, proposed here and there. The most familiar and perhaps the most available plan of the sort is that which proposes to require banks to have outstanding a certain percentage of notes based on bonds before they become eligible to take out notes without bond security. This would mean that an inflexible volume of bank notes was kept outstanding, or at all events that an inflexible volume of bonds was held by the banks to protect such outstanding notes in case they should be issued, and that whatever new form of currency might be provided for would come out in excess of or in addition to the basic volume of notes and bonds already referred to. The plan would partially destroy the possibilities of elasticity in the note currency system, but at the same time it would operate to keep up the value of the existing bonds for the time being. The question would then be whether the effort to sustain the value of the bonds in this manner during the remainder of their life was not too great to be compensated for by the saving in interest thereby effected. The general opinion of students of the subject undoubtedly is that this temporary method of sustaining the value of the bonds is undesirable, and that it is far better to recognize the facts in the case and take up the securities in such a way as to relieve the banks from any danger of further loss, the Government bearing the increased interest charge and leaving the banks to turn in their securities at will.

What has been thus far said has been founded upon the assumption that agreement had been reached with reference to the method of note issue to be followed when once a plan for retiring the old notes and disposing of the bonds had been agreed upon. While no such agreement has ever been arrived at, it is true that substantial agreement has been reached with reference to the basis on which the notes which are to supersede national-bank issues shall be put out.

Another phase of the note-issue question is seen in connection with the problem by whom the notes should be issued. The current assumption is that in the event of the creation of any central or cooperative institution the note-issue power now exercised by the several banks should be transferred to and vested in this new organization. There has been a tendency to overestimate the importance of the note-issue function and to treat it as if it were the chief object to be attained in banking legislation. This idea may be attributable to the belief that "emergency currency" is what is needed in order to relieve panics and stringencies, whereas what is actually needed is fluid resources of some kind, whether notes or not. The belief that the notes are very important has also been stimulated by the experience in this country with clearing-house certificates, which are often spoken of as if they were notes. The fact is that they are merely evidences that the banks that have gone into the clearing-house arrangement are willing to accept a credit substitute for money in settling their balances with one another. It remains true that the provision of a satisfactory note currency would be a long step in advance, as compared with existing conditions. With proper control and restriction it would, however, supply a means of obtaining additional circulating media in time of panic or stringency when there was a tendency to hoard money, and would to that extent relieve the danger of collapse due to inability to convert assets into fluid resources. It is therefore a cardinal element in currency and banking reform and should be provided for.

COMMITTEE'S NOTE PLAN.

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." In its essence the plan now recommended by the committee for a new note issue contains the following points:

1. Ultimate withdrawal of the circulation privilege from the Government bonds of all classes.
2. Issue of notes by the Government through Federal reserve banks upon business paper held by such banks.
3. Redemption of such notes and regulation of their amount outstanding at any moment through Federal reserve banks.

The ultimate withdrawal of the circulation privilege means that some provision of proper character must be made for the existing bonds. It is suggested that, first of all, this should mean the payment of the bonds at maturity and a definite statement to that effect.

This the committee has included in its bill. The bonds now have no due date, and while the Government may redeem them after 1930, they are not necessarily payable at that period. If the bonds are to be continued outstanding, it would seem to be an essential feature of their composition that they shall be allowed to retain the circulation privilege. To get rid of this, it is only necessary to declare them due and payable as soon as the Government has the right to apply that principle. But, in the second place, it would appear that the reform of the currency along the lines proposed, if it is ever to make a fair start, should proceed from the abolition of the circulation requirement in the case of banks either organized or to be organized. The committee has, therefore, proposed to repeal that provision of the existing law which requires the deposit of bonds by every bank in stated amounts. This means that banks may, if they choose, entirely free themselves from circulation. In order to enable them to do this, and at the same time to supply the place of the small but steady demand for bonds which was afforded by the purchases made by newly organized banks, the committee proposes to allow a voluntary refunding process to be carried out over a period of 20 years at the rate of not to exceed one-twentieth of the circulation outstanding at the time of the passage of the act. It is probable that if this provision were fully availed of it would mean an annual refunding of 2 per cent bonds amounting to about $37,500,000. In consideration of the action of the banks in surrendering the circulation privilege on the bonds which they thus voluntarily present for refunding, it is proposed to give the banks a 3 per cent bond without the circulation privilege. This is believed to be an excellent business policy for the Government, as it could scarcely borrow at a lower rate than 3 per cent to-day. What it will be able to do at the end of 20 years is entirely problematical, but it is a fact that the circulation privilege is worth at least 1 per cent, and in surrendering it the banks get no undue consideration from the Government. They do, however, materially facilitate the process of converting the old national-bank notes into the proposed new issue of Federal reserve Treasury notes.

COST TO THE GOVERNMENT.

That the cost to the Government of this conversion will be 1 per cent on the amount converted, or in the last analysis very near $7,500,000, if all the bonds should thus be surrendered is obvious; but it is also clear that the change would, for reasons stated, be an excellent investment for the Government. The committee has arranged to give the proposed Federal reserve board power to tax the new currency at such rate as it might deem best, and should it impose a tax of 1 per cent the Government would be reimbursed for any excess interest payments which it might be required to make on the new bonds. Over and above this plan of recouping itself for any losses is the fact that the Government is to receive a substantial share of the earnings of the proposed institutions of rediscount. If the plan of the committee should be accepted and carried through in complete form, the result would be a profitable one for the Government.

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 public reform. It believes that the 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.

The committee is of the opinion that in order to have the new currency at once satisfactory and effective, it must be (*a*) sound and (*b*) elastic. The soundness of the new notes will, in its judgment, be amply secured by the fact that they are made obligations of the Government and a first lien on the assets of the Federal reserve banks issuing them, while they have also been immediately protected by the hypothecation of first-class commercial paper in the hands of an agent of the Federal reserve board at each of the banks. Their elasticity depends entirely upon two fundamental elements — (1) the provision of an adequate money fund for their redemption and (2) provision for the prompt presentation of the notes. The money fund is provided by the requirement that no notes shall be issued by a Federal reserve bank unless 33⅓ per cent of money shall have been segregated in the vaults of the issuing institution for the purpose of paying such notes upon presentation by any holders. The banks are left to provide this fund, and are both vested with the duty and equipped with the power to obtain it and hold it, either by withdrawing it from domestic channels or importing it. They are required to redeem the Federal reserve Treasury notes, both of their own issue and those issued by other Federal reserve banks, whenever the notes may be presented to them from any source; while, as a central point of redemption, it is provided that the Treasury Department shall pay the notes out of a fund of money (constituting part of the 33⅓ per cent referred to) which shall be placed in their hands by the several banks. This means that the Federal reserve Treasury notes will be redeemable in money at each of the 12 banks and at the Treasury, while the requirement that the notes shall be payable to the Government and to any bank for deposit purposes will be tantamount to a quasi-redemption at every point where banking is carried on. In order to insure the prompt presentation of the notes for redemption, thereby avoiding danger that they may accumulate in the bank vaults, the bill refuses to authorize their use as reserve money by member banks, while of course they will be excluded from the reserves of Federal reserve banks.

Provision is also made whereby they will be prevented from accumulating in the Treasury or any of its subtreasuries even in small quantities. It is believed that these provisions will insure the prompt return of the notes, thereby producing genuine flexibility in the currency. The notes will be taken out whenever business paper eligible for presentation to Federal reserve banks for rediscount is created; and as such paper matures, is paid off, and shrinks in volume the basis for the notes will correspondingly shrink, and either the notes themselves or an equivalent amount of lawful money will be withdrawn from circulation. It is an undoubted feature of the measure as now drafted that it will furnish an ample mechanism for insuring the cancellation of the notes as well as for their issuance. While this process is going on, there will have been an active redemption of the notes, owing to the operation of the provisions for exchanging them for money already sketched.

USE OF GOVERNMENT FUNDS.

One feature of the proposals for legislation contained in the committee's bill is the recommendation that the funds of the Government of the United States received by it as a result of current business transactions and heretofore held in the Treasury shall thenceforward be deposited with the Federal reserve banks, the latter institutions to act as fiscal agents for the Government in all of its transactions thenceforward. This recommendation is of fundamental importance. The Independent Treasury system of the United States under which the Treasury Department now carries on its operations dates from 1846 and is the result of the legislation then urged and adopted for the purpose of putting the country upon a so-called hard-money basis. Whatever may be thought of the idea of actual specie payments and of segregation of Government cash, both when it comes into and when it goes out of the Department of the Treasury, experience has shown that the system is not feasible. It was necessary to suspend the Independent Treasury system, practically speaking, when the Civil War broke out; and upon every subsequent occasion of stress or difficulty in the market a repetition of this suspension has become practically unavoidable. It has been necessary on those occasions to redeposit the funds of the Government in banks in order that the commercial community need not be deprived of the use of them even for a short time. At times it has been found expedient, if not absolutely necessary, to temporize with the law and with the technical requirements of the Treasury system, and practically to abandon the plan of requiring cash payments even when that was theoretically lived up to—this again in order to avoid any withdrawal of urgently needed funds from the business community.

In normal times the withdrawal of these funds has, of course, been far less noticeable in its influence upon the business world, although at all times it has been a fact that the withdrawals did disturb in a measure the natural balance and distribution of funds between different parts of the country and did thereby tend to embarrass some parts of the country much more than others, owing to the fact that withdrawals of cash due to the payment of taxes were neither identical in amount nor proportionate in importance in these several sections. The inadequacy of the Independent Treasury system and of the present method of making public deposits has indeed been fully recognized by Congress when it provided that all such deposits in banks should be made only upon security of United States bonds, a requirement which means, if it means anything, that the banks called national and under congressional supervision, although deemed safe enough for the use of the public, are not safe enough to serve as depositaries of public funds—a situation which, if actually what it seems to be, is both ridiculous and disgraceful. This condition of affairs would, however, be greatly aggravated and would become even more anomalous if Congress were to authorize the creation of a new set of banks intrusted with the power of holding reserves and acting as the intermediaries through which a new currency is issued, yet unable to be trusted as custodians of Government funds. Both for economic reasons and because of considerations of the logic and dignity of the situation, it is desirable to have the current receipts of the Government deposited in the new banks and its disbursements made by drawing upon these institutions. The Treasury is in no way interfered with by this process save in so far as it is relieved of some routine duty. It is left to manage the fiscal affairs of the Government in precisely the way that is now practiced, but the actual funds are placed with the Federal reserve banks, where they will continue to be available for the banking needs of the community which created them and which is responsible for the solvency and activity of the business processes that afford the basis of taxation and thereby supply the fundamental resources of the public Treasury.

BENEFIT FROM DEPOSITS.

Too much can not be said of the benefit that will be derived from the continuous depositing and withdrawing of public moneys through the Federal reserve banks, as compared with the present artificial system of periodically contracting currency through heavy withdrawals due to large payments for customs and internal revenue and of periodically expanding the currency through deposits in the banks, which, however wisely selected, can never restore the funds to exactly the same channels from which they were drawn. A very large share of responsibility for the past panics and crises of the United States must undoubtedly be assigned to the Treasury system which has been responsible for this sporadic and spasmodic movement of funds. In unskilled or selfish hands, the power thus bestowed upon the executive branch of the Government may be, as it has at times become, most dangerous to the public welfare, while it is always a source of grave responsibility and danger scarcely to be overestimated in its importance. The usual consideration against placing Government funds in the banks has been that by so doing certain banks were favored at the expense of others while the Government was deprived of its legitimate return upon the moneys that it furnished. Under the proposed plan, no such danger exists. Power is given to the Federal reserve board and to the Secretary of the Treasury, jointly, to establish a rate of interest upon public deposits, thereby rendering it possible for the Government, if it chooses, to assure itself a fair' adequate return for its funds from the very time that they are placed in the banks. Under the section of the proposed bill which provides for a distribution of earnings the Government of the United States is given 60 per cent of all net income after the banks have received 5 per cent upon their invested capital. The Government is therefore in position to get its full and due return for every dollar that it places in the hands of the banks, while the community has the use of the money thus left subject to the disposal of trade and commerce according to their necessities. This is as it should be, since it amply protects the Government, safeguards the public interest, and assures the returns of the profits from the use of the funds to the Government after the banks have received the fair going rate of return for carrying on their business and performing the routine operations connected with their duties as fiscal agents of the Treasury.

There is another aspect of this Treasury deposit system that deserves mention in this connection. The bill provides for the depositing of funds not in any one bank, and not in accordance with any system that would place the moneys in any particular group of banks, but for the depositing of the funds in such banks as from time to time may be deemed wise, having due regard to an equitable distribution of these moneys among the different sections of the country. The power is, however, retained to make redistribution whenever deemed best, and this means that the provision is important as an adjunct to the power of the Federal reserve board over rediscounts and rates of interest as well as over reserves.

EQUALIZING RESERVE FUNDS.

It is evident that the Federal reserve board and the Secretary of the Treasury could, by shifting the deposits of the Government from place to place as occasion demanded, meet conditions of stringency and difficulty in the market, or furnish exchange funds as occasion appeared to require. The power would naturally be exerted before any resort was had to any method of interfering with the loans of the banks or with their reserves, and would of course be far more satisfactory as a means of equalizing resources than the exercise of the compulsory rediscount power. What has been done by various Secretaries of the Treasury in times past, and has been successfully done, toward the readjustment of banking accommodation, by the making and withdrawal of public deposits in different parts of the country, with comparatively meager funds, under the present Treasury system, gives a faint suggestion of what might be accomplished in the way just indicated. We have stated that in our judgment the use of the Treasury funds for deposit purposes in the manner referred to has never been desirable and has frequently resulted in leading, through long-continued employment, to panic or to artificial and injurious conditions of various kinds. What has just been said does not in the least weaken the force of the general observation thus restated. The harm resulting from past efforts of this kind has arisen primarily from the fact that they were necessarily carried out without intimate knowledge of or close association with the banking mechanism of the country.

The evil which came from these efforts was due to the lack of adaptation to existing conditions. Under the proposed plan the funds of the Government will never be removed from the uses of the commercial community, but they will continue in the general regions of the country where they originated, while those who are to be charged with the duty of overseeing the management of Government funds will have at their disposal the information that is needed to enable them to readjust deposits or to grant temporary relief through the shifting of Government resources should conditions suddenly require action of that kind. The situation will not only be such as will put an end to the vicious and wholly artificial state of things existing under the present type of Treasury organization, but will substitute for it a helpful system whereby definite governmental authority, closely informed concerning banking conditions and constantly in touch with the development of credit in all parts of the country will be in control of an enormous mass of fluid resources which it can transfer by normal methods through the ordinary channels of trade from one part of the country to another, as conditions warrant; or, better still, can direct the flow of this mass of resources now here and now there, as circumstances call for it. The process will be conducted with knowledge of the highest order and will be free of the difficulties which have heretofore beset the making of Treasury deposits. It will be similar in operation to the function that is performed by the central banking institutions of foreign countries and will be carried out by exactly similar methods save that, because the authorities in charge of it are not hampered by commercial motives and are not interested more in one part of the country than in another, they will be able to do the work without any of the interfering considerations of private profit which frequently prevent the operations of a central banking institution from being carried on solely in the public interest. In the best sense of the word, the Government will be completely "out of the banking business" and in the best and proper sense of the word it will be in that business, neither under the necessity of interfering with normal trade operations nor of artificially interposing to bolster up weak banks in any part of the country.

BANKING FACILITIES FOR FOREIGN TRADE.

It has long been a ground of complaint that the national banking system provided no adequate means for the establishment of American banks in foreign countries. This criticism has had some warrant, and in view of the rapidly expanding foreign trade of the United States it is deemed wise to make proper provision for banking machinery in foreign countries which shall be closely controlled by home institutions. The bill proposed by the National Monetary Commission sought to accomplish this end by providing for the creation of a special type of institutions to be organized by national banks as stockholders and to engage in operations abroad. The committee is of the opinion that no such elaborate mechanism is necessary, but that every good purpose of the monetary commission plan can be attained by the adoption of the plan it has proposed, which consists essentially of provision for the establishment of foreign branches by existing national banks when such banks have an adequate capital for the kind of work in which they propose to engage and are found by the Federal reserve board to be in proper condition for undertaking such an enterprise. The proposed plan is simple and, it is believed, sufficiently effective for the purpose. Under it national banking institutions will be in position to create branch offices at such foreign points as they may deem best, assigning to them a due share of capital and conducting their affairs separate from those of the home office in order that there may be no difficulty in ascertaining at any moment the distribution of the business of the institution. It is believed that with the extension of national-bank powers which is provided for in the present act, such branches of national banks would be amply able to meet the requirements of their clientele wherever it might be necessary for them to operate.

EXAMINATIONS OF NATIONAL BANKS.

For some years the national banking act has been found to be seriously defective in its provisions for examinations. In attempting the organization of a more closely woven system of banking the committee therefore feels impelled to urge the necessity of stiffening existing examination requirements, while it also feels the imperative character of the demand for careful examinations of Federal reserve banks. In order to fulfill all the requirements of the case it therefore has included in the proposed measure a considerable extension of the examination function, dividing this between the Comptroller of the Currency, the proposed Federal reserve board, and the Federal reserve banks themselves. The committee is of the opinion that the authority to institute bank examination should be lodged with every part of the banking organization competent and trustworthy enough to exercise it, not because, as some have asserted, it is desired to have bank examinations constantly in progress, and not because of any belief that such examinations would be in fact much more frequent than they now are, but because it is believed that the exercise of the power to examine whenever necessary is essentially a fundamental and desirable power, and one whose exercise, if judiciously carried out, will result in the early detecting of dangerous conditions and their correction before they have reached a desperate stage. It is believed, moreover, that the provisions with reference to bank examinations, if properly carried out, will largely if not wholly obviate any necessity for the clearing-house examinations, which are carried on at the present time in behalf of associations of banks and of which there has been more or less complaint on the ground, however unjustified, that such examinations were unfairly carried on or were in some way used for the benefit of individual banks or bankers. That such charges have frequently been unjustified is undoubtedly true, but it is believed that the new system of placing all such examinations under authorized control and supervision will eliminate many possibilities of criticism or attack that lurk in the present system and may at times give rise to prejudice and specious assertions of favoritism.

DETAILED REVIEW OF BILL.

Having thus examined in outline the principal considerations which have led to the formulation of the proposed bill and the chief ideas that have dictated the form that has actually been given to it, it is now desirable to examine the terms of the proposed measure in detail.

SECTION 1.

Section 1 creates a short title which may be used for convenience, sake in the future in referring to the act. It needs no further discussion.

SECTION 2.

Section 2 provides for the districting of the country and for the organization of a reserve bank in each such district. These two topics may be discussed separately, it being prefaced that the purpose of the proposed bill is to substitute for the national currency associations of the Aldrich-Vreeland law a series of reserve banks to be organized in independent districts and to do in a better and more continuous way the services which had been expected of the currency associations themselves.

It has been explained at an earlier point that the purpose of any thorough banking legislation must necessarily be the creation of a means for rediscounting existing paper and for furnishing either a bank credit or an elastic and reliable bank-note issue as the medium by which such discounts may be afforded. Without going more into the theory of this proposition, already thoroughly well covered, it may be stated that the medium through which the present bill proposes to attain these ends is the organization of a reserve bank to be entitled a "Federal reserve bank" in each one of the Federal reserve districts to be established as provided in section 2./ In briefest terms, then the reserve bank in each district will do for existing banks what an ordinary bank does for its customers; that is to say, it will hold their surplus funds, furnish them loans, offset their payments and receipts, and supply them with the means of making remittances. In broad theory there will be no difference between the services performed by the reserve banks or bank and those performed by the existing banks for individual customers. Unless it be true that the reserve banks are granted some special privilege or relationship to the Government there will be no reason why they should not be organized upon the same basis and for same general purposes as existing banks. Indeed, with one or two minor modifications of existing law they could be so organized under the present national bank act. It is to be noted that some national banks now organized and doing business in the larger cities perform in a measure very much the same functions for smaller banks which do business with them that it is now proposed to have the reserve banks to be organized under this act do for the banks that are to be their constituent stockholders. The existing banks which perform this function do it for profit, and when opportunity offers make exorbitant returns for themselves on the transactions they enter into. The proposed reserve banks are to be cooperative institutions, rendering their service for the good of all the banks that are stockholders in them, as well as for that of the public, while the Government is to get the excess profits of the institutions. The detailed functions of the reserve banks can be best brought out in connection with subsequent sections, where they are dealt with more elaborately.

It is evident that before the different banks can be organized and placed it must be decided where they are to be placed and how large are to be the districts in which they shall operate. For reasons which are already partly apparent and will be made more so as the discussion goes on, one such bank in a district is all that is needed or could profitably or properly be organized there. This necessitates care in choosing the locations and fixing the size of the districts. Two fundamental considerations are sought in performing this work.

1. To provide each section of the country that constitutes a geographical and business unit with a reserve bank to serve its local banks and hold their reserves, making the districts sufficiently numerous to enable each such section to feel that its wants are met by its own local reserve institution under its own control. At the same time it is recognized that the districts should not be made so small

as to cut the capital of the reserve institutions to a figure that would make them weak.

2. To see to it that reserve banks are given a capitalization that will enable them to do what they are designed to do and are so situated as to avoid any shock to business enterprise resulting from the shifting of bank reserves from existing banks to the new reserve banks in the way outlined in the present bill.

It is believed that the fixing of the exact number of banks and the delimination of the districts are points that can only be exactly met after careful investigation by a properly qualified body appointed for that purpose. It has, however, been thought wise to fix the minimum number of such banks to be established in order that in passing the law the community may be assured of adequate provision for its needs. It is proper to say frankly that much difference of opinion as to the number of such banks has been expressed, some placing the desired number as high as 50, others as low as 3. Those who advocate the larger number think that there should be one such bank in practically every reserve city, on the ground that the reserve cities of the present day owe their existence to a definite need which has resulted in their establishment, and that this need ought to be recognized under such legislation as may be passed. Those who advocate the smaller number think that the banks should be created in central reserve cities only. They say that these central reserve cities are now the ultimate holders of reserves and that if they alone had the reserve banks proposed to be organized under this act there would be very little friction or difficulty in passing from the existing régime to the proposed plan.

The Committee on Banking and Currency finds itself unable to side with either of these groups of thinkers. It believes that the number of reserve banks to be created ought to be large enough to meet the reasonable needs of the country and should not be so small as to play into the hands of those who want to establish a very high degree of centralization. It also thinks that the reserve banks should be few enough in number to make them really independent institutions, likely to look to one another for aid only under emergency conditions, and hence not in danger of being controlled by other reserve banks. It has therefore fixed the minimum number of reserve banks at 12. This number has however not been arrived at from theoretical considerations solely, but also as a result of the following data:

1. The committee has asked a considerable number of bankers their views as to the proper number of such institutions. Many of these bankers were questioned during the hearings of last winter. Among them were Messrs. A. B. Hepburn, who thought that if such a plan were adopted the number should be one in each clearing-house district (hearings, p. 10); Sol. Wexler, who thought that the number should be about 15 (hearings, p. 623); Victor Morawetz, who fixed the number at 1 in each clearing-house district (hearings, p. 48); Sir Edmund Walker, who thought the number might run as high as 20 (hearings, p. 666); and others. Mr. J. V. Farwell, a well-known merchant of Chicago, suggested 5 to 7 as the number (hearings, p. 452).

2. Experience under the Aldrich-Vreeland law has resulted in the organization of 18 currency associations.

3. The Aldrich bill, so called, or National Monetary Commission bill, provided for a central reserve association with 15 branches or 16 banking institutions, open to the banking public, in all.

4. Examination of the present bank capital of the country shows that the number of banks on the basis of capital contribution could not well be in excess of 12 or 15 if the capitalization of the reserve banks themselves was to be sufficiently strong to make them effective. Assuming that the total capital of the national banks to-day is somewhat over $1,000,000,000, and assuming further that State banks possessing a capitalization of one-half that amount were admitted to the proposed institutions, it might be estimated that these Federal reserve banks would be owned by banks with an aggregate capitalization of $1,500,000,000. It will be shown later in the present discussion that the capitalization contribution to be exacted of each bank is 10 per cent of its present capital. That would make a total capitalization for the proposed reserve institutions of $150,000,000. Assuming that this amount was contributed and that there were 12 such institutions, their average capitalization would be $12,500,000, which is believed to be ample to meet the needs of the communities represented. If it should be roughly assumed that one-third of the proposed banks would be near the lower limit of $5,000,000 capitalization, this might mean five reserve banks with a gross capitalization of $25,000,000; five reserve banks with an average capitalization of, say, $7,500,000 and a gross of about $37,500,000, so that there would be left five with a gross capitalization of $87,500,000, or an average of $17,500,000. It is probable that as New York City already possesses two banks of $25,000,000 capital each, while her banking resources are very large otherwise, the bank of the New York district might be given a capitalization of $30,000,000 or $35,000,000, in which case the other four banks belonging to the group of large institutions might have an average capitalization of $13,000,000 apiece. These figures are all purely tentative and are merely intended to represent the way in which the districting might operate. Further attention can be given to the subject of districting and its effect upon the banks in connection with the study of the reserve section of the bill, which will be taken up somewhat later in this discussion. It is undoubtedly true that the proposal to create as many as 12 reserve banks will receive very sharp criticism from banking interests which are desirous that there shall be as high a degree of centralization as possible in the new system, while it is also thought probable that the proposed number will be sharply attacked by others who think that the 12 is by no means enough to give all portions of the country a chance to be fairly represented and adequately heard in connection with the rediscounting of paper. The figure fixed has, however, been the result of careful study and the committee feels entire confidence in its approximate correctness. It recognizes that in the future as the country grows there will be need of an increasing number of reserve banks, and therefore the power is given to create more such banks in the future as occasion requires.

Inasmuch as no machinery is in existence for the creation of such banks, and inasmuch as the process of districting the country can not be described in any hard and fast manner, it has been deemed best to leave this analysis of business conditions for which there are at present no adequate statistics within reach, to a committee including the Secretary of the Treasury, the Attorney General, and the Comptroller of the Currency. In order that they may do their work correctly and successfully it will be necessary for them to ascertain with care the business connections of each of the principal cities of the country in order that the districts in which such cities are located may be properly shaped in a way that will not alter the present course of exchange and interbank remittances. The task thus prescribed may be one of some considerable length, and therefore it has been deemed best to leave the establishment of the details and the fixing of dates for organization to the judgment of the committee in question, subject only to the provision that in general it shall be completed within a reasonable time. Inasmuch as the work of making the distribution and apportionment of banks by districts will involve some expense, it is proposed to assign a moderate sum to cover the cost of travel, employment of expert assistance, etc.

SECTION 3.

Section 3 relates to stock issues, and divides the share capital into shares of $100. This unit is adopted because it corresponds to the unit of share capital in the national banking system, and is therefore an easy basis for computation of the share capital which a given bank will be required under the act to take out. The fact that it has been determined to have the share capital of the Federal reserve banks bear a fixed relationship to and be subscribed by the existing banks of the country make it necessary to provide some means of recognizing the growth of the system or its shrinkage, as the case may be. The second clause of section 3, therefore, calls for the increase of the capital stock of the Federal reserve bank according as the amount of capital in the system increases and is decreased by a converse process. This means that no Federal reserve bank would ever have a fixed capital, since that capital might easily change almost from day to day. The fact remains that the capital would be a fixed percentage of that held by the member banks, while in view of the later provisions of the act it is believed that the amount of this capital could be easily ascertained at any moment and the payments to withdrawing banks be made without any serious difficulty.

A second feature of section 3 is the provision that each Federal reserve bank may establish branch offices subject to the regulations of the Federal reserve board not to exceed one for each $500,000 capital of the stock of each Federal reserve bank. After due study it has been required that such branches should be established only in the district in which the Federal reserve bank is located. Branches of different Federal reserve banks will, therefore, not compete with one another, but will be simply offices established for the convenience of the member banks, facilitating their relations with the Federal reserve bank in which they are stockholders. The question may fairly be raised whether a Federal reserve bank should be allowed to establish one office in each of the other Federal reserve districts should it so desire, but after due consideration it has not been deemed desirable to permit such an extension of the power to create branches.

SECTION 4.

Section 4 provides for the incorporation and organization of the Federal reserve banks under the conditions already outlined in the preceding section. Fundamentally the purpose of the section is to authorize the incorporation of such a reserve bank in each district with powers precisely analogous to those of national banks except in so far as altered by the act itself. The organization, officers, and the like of the reserve banks will under the terms of this section be the same as those of the national institutions. There is no reason why any important distinction as to type of organization should be drawn or exist between the typical reserve bank and the typical national bank. This is worthy of special note because of the claim that Federal reserve agents, whose functions will presently be described, would practically be the active managers of the reserve banks. They would in fact be chairmen of the boards of directors, but as in the case of national banks such a chairmanship might be more or less active, according as the bank itself chose to determine.

The first clause of section 4 provides that a "sufficient number" of banks having made and filed with the comptroller a certificate, etc., shall thereupon be organized. As was provided in section 2, the minimum capital of a reserve bank is to be $5,000,000, so that the sufficient number referred to would mean in practice banks having a joint capitalization of at least $50,000,000. The sections of the national banking act referred to as defining the powers of the banks in question are those which state generally the limitations upon the functions of national banks and the rights and authority vested in them. The final provision of the first paragraph of the section giving to the Federal reserve bank a charter life of 20 years is the same as the corresponding provision of the national bank act. The power of Congress to dissolve the bank at an earlier date if desired is likewise identical with the power reserved to Congress in the case of national banks.

In dealing with the organization of the reserve banks the bill proposed by the committee has sought in section 4 to furnish a democratic representation of the several institutions which are members and stockholders of a reserve bank. To this end, the directorate is divided into three classes, each consisting of three members, while the stockholder banks are similarly divided into three groups or classes. The bill provides that the election of one member of class A and one member of class B shall be intrusted to each one of the groups into which the stockholding banks are subdivided. As it is required that each of the banking groups thus created shall contain approximately one-third of the number of banks in the district, it is clear that the banks comprising one-third of such capitalization would have a representative of their own in class A and also in class B. It might well be that the one-third in any given district would include a very small number of banks and that the director in question would thus be the representative of but few institutions. This, however, is deemed far better than to permit of the general choice of directors by all banks voting indiscriminately, it being the belief of the committee that by the method proposed each group of banks will preserve its autonomy and secure due hearing on the board of directors.

SECTION 5.

Section 5 deals entirely with the method of increasing and decreasing the capital stock of Federal reserve banks and the effect thereon of corresponding changes in the stock of member banks. The general purpose is to require member banks to pay additional pro rata subscriptions as they increase their capital stock and to permit them to withdraw capital subscriptions in the same manner as they reduce their capital; or, in case they go out of business entirely through failure or liquidation to permit them to withdraw the cash paid in, assuming, of course, that there has been no loss sufficient to impair the capital of the reserve bank. Should such a loss occur the reserve bank would presumably have called sufficient of the unpaid subscriptions to restore its capital to the original amount, in which case the withdrawal of a sum equal to the original cash paid subscription would simply give the bank what it put in in the first place, the loss meanwhile having been borne by its contribution made on call. The prohibition upon the transfer or hypothecation of shares in a Federal reserve bank is, of course, necessary in order to prevent the reserve bank from ceasing to be a democratic organization composed of members contributing in a like pro rata proportion of their actual available cash resources. Any other plan might result in the concentration of share ownership in a few hands. The intent of the bill is to have all banks vote alike at elections and as a preliminary requirement to enforce the retention of equal percentage of capital by each in the business of Federal reserve banks.

SECTION 6.

Section 6 is complementary to section 5 and merely provides for the treatment of the stock of Federal reserve banks belonging to member banks which become insolvent. The fundamental idea in it is that of intrusting the Federal reserve bank with the function in the case of a failure of deducting from the original amount of the failed bank's subscriptions any debts or claims due from said insolvent bank to the reserve bank and paying the rest to the receiver of the failed bank. This, in effect, gives the reserve bank a prior lien upon the assets of a failed member bank up to the amount of its cash-paid subscription which of course is a carrying out of the principle involved in requiring the member banks to subscribe 20 per cent, although they pay up but 10 per cent of their cash capital as a contribution to the stock of the Federal reserve bank of which they are members.

SECTION 7.

In section 7 it is provided that the division of earnings of Federal reserve banks shall be such as to give to the Government a due share of the proceeds of the banking operation after what is considered a fair remuneration for Federal reserve banks themselves has been provided. It is also sought to devote the share of earnings going to the Government to the reduction of the public debt. In general, the process of dividing the earnings is divisible into three stages under this section:

(*a*) The first step in the process of dividing the proceeds of the banking operation is that of giving to the subscribing banks which own the stock of the Federal reserve banks a due return for the use of their funds. This, after due consideration, has been fixed at 5 per cent—a rate of dividend which, however, is to be cumulative. This should not be confused, as has been done by some critics of the proposed bill, with a rate of 5 per cent from the capital of the banks. The banks, of course, will not set aside a part of their capital for this subscription but will devote a part of their current funds to it. The real question then is whether the rate of 5 per cent represents about the normal rate of return from current bank investments. Considering the high character of the security offered we are of the opinion that it does do so.

(*b*) The second step in disposing of the earnings is that of the accumulation of the surplus. While it is not supposed that the Federal reserve banks will incur severe losses, on account of their conservative nature and the auspices under which they are to be carried on, it is believed that the accumulation of a surplus to furnish an increased source of banking capital for the reserve banks, and so far as practicable to obviate any necessity of calling for any of the unpaid balances of the original capital subscriptions is highly desirable. One half of all net earnings after attending to the claims of the 5 per cent cumulative dividend is therefore to be devoted to the surplus until the said surplus amounts to 20 per cent of the capital of the bank. The remaining one-half is to be divided in the proportion of three-fifths to the Government and two-fifths to the bank's stockholders in the ratio of their average balances with the Federal reserve bank for the preceding year. It will be observed that this introduces a new principle of distribution of earnings not based upon relative ownership of capital stock. More will be said of this point very shortly.

(*c*) The third and final step in disposing of the earnings relates to the distribution after surplus has been fully provided for. Section 7 would give three-fifths of all earnings after the surplus is taken care of to the Government and two-fifths to the member banks in proportion to their annual average balances as before.

It is worth while to consider with some care what this plan of distribution would signify. Assume for the sake of argument that the rate of earning of the Federal reserve banks is about identical with that reported by the comptroller for the national banks of the country, or, roughly, 9 per cent. Taking 9 per cent as the figure, this would mean that with a total capital of $100,000,000 the earnings for the first year would be $9,000,000. Of this sum, $5,000,000 would be required for the dividend requirements. This would leave $4,000,000, of which $2,000,000 would be carried to surplus and the remaining $2,000,000 would be divided as aforesaid in the proportion of $1,200,000 for the Government and $800,000 for the stockholding banks. It is, of course, impossible to state exactly how the division between the stockholding banks would finally turn out, since it can not be definitely stated what balances they would carry with the reserve banks.

THE GOVERNMENT'S SHARE.

It has frequently been asked why the Government should be allowed to share in the earnings of Federal reserve banks at all. There are two reasons of conspicuous and obvious character why it should do so: (1) It vests the Federal reserve banks with the sole and exclusive function of note lending, from which all other banks are debarred; (2) it places the public funds with the Federal reserve banks to an amount certainly vastly larger than that of any other depositor and equal to the combined deposits of large groups of banks. 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. To a substantial share in this earning, leaving for the reserve banks only a fair compensation for their services in taking out the notes, the public is evidently entitled.

The provision that the earnings of Federal reserve banks in so far as paid to the Government shall be regularly devoted to the reduction of the bonded indebtedness of the United States is manifestly a proper use of the income in view of the fact that the Government has incurred an additional interest charge upon its outstanding bonds for the purpose of persuading the banks to surrender their twos from time to time or at the end of 20 years for the purpose of converting the twos. By gradually applying the earnings received by the Government to the reduction of the outstanding bonds, selecting those that are available for circulation, it will be possible to maintain a moderate market demand for the bonds and at the same time to effect a gradual reduction of the outstanding indebtedness as well as, of course, a corresponding reduction of interest charges thereon.

Attention should also be given to the provision exempting Federal reserve banks and the stock held therein by member banks from all classes of taxation, save such taxation as may be imposed upon the real estate held by these banks. In view of the increasing burden of taxation and of the Federal income-tax law, which now furnishes an additional draft upon net earnings, this exemption is likely to prove of material importance, since it amounts to an exemption of a corresponding proportion of the funds of member banks from the payment of taxes to which they would otherwise be subjected.

SECTION 8.

The essential features of section 8 are:

1. The grant of a year's time within which existing national banks may make up their minds whether or not to take out stock in Federal reserve banks under the provisions of the proposed bill; and

2. The provision that in the event of an adverse decision on this subject such national banks as may reach a decision of that character shall be dissolved the remedies now provided by law against such a dissolved bank shall not be impaired.

This in effect means that every national bank now in existence must within a year either (*a*) take out stock in a Federal reserve bank, (*b*) become a State bank under State laws, or (*c*) leave the business entirely. It is evident that any measure of legislation which imposes substantial responsibilities and burdens upon banks will be opposed by some of them, and that unless they are required to assume their duties to the community, they will if they are permitted to make a voluntary choice between their present condition and that proposed for them, elect to continue as at present. No matter how advantageous a plan proposed by Congress might be, many banks would refuse to go into it out of sheer inertia. This was the condition of affairs found by experience to exist at the time when the national banking act was first adopted, and it will be repeated to-day if the whole matter of assuming the new responsibilities prescribed by law is left optional with the banks. In view of the fact that the banks have their own remedy in their own hands, in that they may recharter under State laws if they desire, the measure recommended in section 8 is deemed entirely proper, not to say indispensable. The committee does not believe that it is the province of Congress to bribe or induce the banks to enter the new system, but rather to lay down equitable conditions and then to require their acceptance.

QUESTION OF "COMPULSION."

Much has been said by opponents of the proposed bill with reference to the question of what they call "compulsion." By this is meant the requirement of the bill that national banks shall subscribe to the stock of the Federal reserve banks of the districts in which they are situated, or if they do not choose to do so shall leave the national banking system by surrendering their charters. A few persons have been disposed to contend that there was some illegality or "unconstitutionality" in this section of the measure—a claim which is readily dispelled by referring to existing legislation bearing upon the power of Congress regarding the amendment or repeal of corporate charters. Those who complain of this provision, however, need not be dealt with simply upon technical legal grounds, as the subject has a very much broader bearing, and we believe that there is no one who would wish to visit any hardship or injustice to the banks simply because Congress was within its legal rights in so doing. The general considerations which make it entirely warrantable for Congress to impose certain burdens upon banking institutions as conditions precedent to the grant of national charters to such institutions are quite evident. They appear in all of the various more or less stringent and onerous conditions laid down in the national-bank act for the guidance of the conduct of banking associations. They are also seen in the restrictions imposed by practically all foreign Governments upon the conduct of the banking institutions under their jurisdiction.

The Government, in granting to such banks the power and privilege to operate under the protection and with the prestige of charters emanating from itself, naturally is authorized to make these privileges contingent upon the acceptance of such conditions as it may deem best. Nor is the argument solely to be rested upon these considerations. The proposed bill will ultimately place the banks of the country upon a far more liberal basis than that accorded to them by existing law. This may be demonstrated, among other methods, in the following way: By the terms of the national banking act banks must, in order to become national banks, purchase and deposit with the Treasurer of the United States Government bonds as security for circulation. This requirement is nominally 25 per cent of capitalization for banks up to $150,000 capital and $50,000 for all above that level. In reality the requirement is much stronger than this, inasmuch as no notes can be taken out without a deposit of Government bonds behind them. Inasmuch as the supplying of notes is absolutely necessary if the banks are to meet the needs of their customers even in a moderate degree, the proper measure of the burden imposed on them by this requirement is the volume of the bonds that they have purchased. As is shown elsewhere in the present report, this volume of bonds is now something like $750,000,000, or very nearly three-quarters of the capital stock of the banks. The proposed bill arranges for releasing the banks from this required investment and substitutes in lieu of it a required investment equal to 10 per cent of their capital (paid up), or not to exceed $105,000,000. This is one-seventh of the amount now invested in bonds. Inasmuch as the proposed bill allows the conversion of existing 2 per cent bonds into threes at the rate of 5 per cent per annum, while it gives the banks a year within which to enter the proposed reserve banks as stockholders, it is evident that within one year from the latest date set for the subscriptions to the capital stock a bank owning bonds equal to capital would have been able to obtain through conversion and sale of its securities an amount equal to the required investment in capital.

The answer may be made to this statement that the earnings upon the investment in bank stock are unreasonably and unnecessarily small. How much they will be is of course a matter of opinion, since no one can predict the actual profits of the Federal reserve banks. It is, however, worthy of note that even if the earnings were only 5 per cent they would be in excess of the estimated earnings derived from national bank-note issues, which have been notoriously unprofitable for a good while. The banks receive the 2 per cent on their bond investment and the current rate of interest on their notes (provided they can keep them in circulation), but they are obliged to bear the expenses of engraving and printing, redemption, etc., so that it has long been axiomatic that the profits on bank-note circulation were very small—so small that many banks have taken out few notes, some even holding their required minimum of bonds without taking out any currency. From this showing it is evident that the idea of "compulsion," instead of being a novelty is a very old one, as well as one that is widely accepted among civilized countries to-day, while the severity and degree of the compulsion as to the use of the bank's current funds entailed by the proposed bill is very much less than that involved in the provisions of the present national bank act. There is in fact no reasonable basis for the complaint with regard to compulsion. National banks after the passage of the proposed bill will be freer, more able to dispose of their funds as they choose, and far less subject to serious interference with their legitimate use of resources than they are to-day.

SECTION 9.

Section 9 is a general permission to any State bank to become a national bank and thereby to become eligible upon the same terms as national banks for membership in a Federal reserve bank as a stockholder. The provisions follow substantially the lines now laid down in the national banking act with reference to the conversion of State banks into national institutions and need no considerable comment, being repeated here for the sake of making plain the conditions under which such conversion may occur subsequent to the passage of this act, that there may be no reasonable doubt in regard to the matter, and that it may be certain under precisely what terms and conditions State banks may make the transfer required.

SECTION 10.

After much examination of the subject, it has been deemed best by the committee to permit State banks to become members, i. e., stockholders in Federal reserve banks, without themselves becoming national banks. This concession has been determined upon partly from the standpoint of the banks themselves and partly from that of the new system. The success of the new system would be very largely influenced by its extent and scope. If it becomes practically inclusive of all the banks of the country that are in strong condition, its opportunity for service will be much greater than it could otherwise be. On the other hand, the committee has doubted whether, from the standpoint of the banks themselves, it would be acting fairly were it to debar them from membership in the new concerns.

It has been plain, however, that inasmuch as State banks are organized under different codes of legislation it would be unfair to permit banks to become stockholders in the reserve banks and to enjoy the advantages open to national banks which are stockholders unless such banks were subject to practically as high a standard of banking requirement as the national banks with which they compete. It has been felt that the particulars in which greatest care should be exercised on this score are (*a*) capital and (*b*) reserves. The fundamental idea of section 10 is to require compliance with the terms of the bill and of the national banking act as a condition antecedent to the holding stock in a reserve bank by any State bank. This does not altogether place the State banks upon the same basis as the national, inasmuch as they are not thus subjected to the same regulations with respect to investments and general business. It is believed, however, that the principal requirements will thus be met and that the provisions of the section are about as far as the measure can reasonably go with certainty of being held legal and at the same time of proving feasible and available in practice. As a necessary power in connection with this question of membership section 10 confers upon the Federal reserve board the power to establish by-laws for the general government of its conduct in acting upon applications made by State institutions, while it intrusts to the board the power to approve applications when proper or to suspend banking associations from membership when the provisions of the act are violated, and to secure the cancellation and retirement of their stock, returning the value thereof to the banks so suspended.

SECTION 11.

In this section provision has been made for the creation of a general board of control acting on behalf of the National Government for the purpose of overseeing the reserve banks and of adjusting the banking transactions of one portion of the country, as well as the

Government deposits therein, to those of other portions. The number of members of this board has been fixed at seven, after careful consideration of other possible memberships, and it has been determined that the board as thus made up should consist of two distinct elements, the one including three regular officers of the National Government, the other four specially appointed officers whose duty it should be to devote their whole time to the management of the affairs of the reserve banks and the performance of the duties assigned them under the present bill. The three officers chosen from the existing staff of the Federal Government are to be the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency. It is evident that the Treasury Department not only is, but will continue to be, a fundamentally important factor in the financial organization of the country, while the Comptroller of the Currency, in charge as he is of the national banking system, will be a necessary adjunct in the management of the reserve bank system proposed in this bill. The causes for the selection of the two officers thus named are therefore self-evident. The Secretary of Agriculture has been added because of the belief that conditions in the producing regions of the country would deserve special consideration at the hands of the Federal reserve board, the Secretary of Agriculture being the natural representative of the interests of these sections, while it is further thought that the presence of a member on this board whose direct concerns are not primarily those of technical business or banking will be beneficial and will give the deliberations of the board a broader character than they would otherwise possess.

The four members chosen by the President for special service on the Federal reserve board will necessarily be intrusted with the heavier and routine duties pertaining to this board, the regular officers of the Government being naturally engaged in large degree in the discharge of their ordinary functions. It is therefore important to provide for the proper choice of the four officers thus called for. The committee has thought it wise that they should be assigned a tolerably long tenure, and has accordingly fixed that tenure at eight years, providing, however, that the first appointees shall be so distributed with respect to tenure of office as to bring about a rotation, so that all members of the board shall not change at any one time. In the second place, it has been deemed wise to provide that not more than two of these four members shall belong to the same political party. It can not be too emphatically stated that the committee regards the Federal reserve board as a distinctly nonpartisan organization whose functions are to be wholly divorced from politics. In order, however, to guard absolutely against any suspicion of political bias or one-sidedness, it has been deemed expedient to provide in the law against a preponderance of members of one party.

The provision that the President in making his selections shall so far as possible select them in order to represent the different geographical regions of the country has been inserted in very general language in order that, while it might not be minutely mandatory, it should be the expressed wish of the Congress that no undue preponderance should be allowed to any one portion of the Nation at the expense of other portions. The provision, however, does not bind the President to any slavish recognition of given geographical sections.

Finally, it has been thought wise to insert a provision that at least one of the four persons so chosen by the President shall be an experienced banker. This, of course, does not mean that other members of the board would be inexperienced in or ignorant of banking. On the contrary, the assumption is that they would not be chosen unless at least tolerably informed in the banking field, and that in all probability they would be not only experienced in banking but men of broad business knowledge and culture. This, however, is a matter that must necessarily be left to the appointive power, which not only should but must, in order to give good results, be vested with discretionary authority sufficient to enable it to make careful choice from among all of the best material available for such a board. It might easily be that a man of high business caliber, thoroughly desirable as a member of the board, would not have had a technical banking experience, notwithstanding that he might be well equipped for the work. The Comptrollers of the Currency in times past have not always been bankers in the technical sense, and some of the most efficient among them have had least technical experience in banking at the time when they assumed office. It is therefore believed safe to vest this whole matter in the hands of the President with large authority, believing that he will be able to use the same care and discrimination that he employs in choosing the Supreme Court of the United States. For obvious reasons it is considered wise that every member of the Federal reserve board designated by the President shall surrender any banking connections he may have had at the time of his nomination, and for equally obvious reasons it is deemed best that the board shall annually report to the House of Representatives, thereby establishing a direct relationship between the board and the Congress. The President is authorized to designate one of the four appointees as manager of the Federal reserve board and one as vice manager, this being deemed wiser than to throw upon so small a board the duty of selecting executive officers from among its own membership. In designating the Secretary of the Treasury as ex officio chairman of the Federal reserve board the bill aims to preserve the general concept of official responsibility and duty which is fundamental to the conception of this board. In ordinary times the Secretary of the Treasury's relation to the board would be largely formal. In times of stress or sudden danger he might become an active and effective working member of the board.

The final paragraph of section 11 is intended to make the Comptroller of the Currency in all respects answerable to the Federal reserve board, thereby giving this board the practical connection it needs with the national banks of the country which are under the direct supervision of the Comptroller of the Currency. This is believed to be desirable, inasmuch as the Comptroller of the Currency, although a member of the Federal reserve board by virtue of the earlier provisions of this section, might otherwise not be held to be answerable to the board in his official capacity as the chief of the national banking system. The paragraph referred to now makes him responsible to the "Secretary of the Treasury acting as the chairman of the Federal reserve board," which implies that the board would have power to instruct the comptroller upon all necessary matters, preferably through the chairman, whenever action affecting the national banks in those respects in which they are subject to the oversight of the comptroller was called for. The proviso at the end of the paragraph in question, however, makes it evident that there is nothing in this grant of authority or in this imposition of responsibility to reduce the functions of the comptroller as at present understood or to render him less amenable than he now is to the Secretary of the Treasury, who is his chief under existing circumstances.

SECTION 12.

"In this section are set forth the basic functions bestowed upon the Federal reserve board." These are not all the powers given to the board, it having been necessary to distribute various other minor grants of authority throughout the bill in the connections to which such grants of authority specifically relate. The provisions of section 12, however, cover sufficiently the fundamental authorities bestowed upon the reserve board. These may now be taken up in order:

(*a*) In paragraph (*a*) is given the authority to examine the affairs of each Federal reserve bank, to require statements and reports, and to publish a weekly showing of condition. This is substantially the same kind of authority which is to-day exercised by the Comptroller of the Currency with respect to national banks, except that it is more constant, close, and intimate as the different nature of the case requires. The powers thus bestowed are identical with those granted to the supervising boards in control of the central banks of Europe.

(*b*) In paragraph (*b*) is given to the board the authority (1) to permit or (2) to require one Federal reserve bank to rediscount the discounted prime paper of other reserve banks. Much has been said of this grant of authority and it therefore deserves careful analysis. In the first place, it is evident that this power is not different in nature from that which is exerted by the head office of a central bank possessing several branches. Such an office can transfer funds from one to another, and withdraw the service of one for the service of the others. It can, moreover, employ the resources of one portion of the country for the advantage of other portions or for the purpose of safeguarding them at critical times if its managers deem such actions to be wisest. Those, therefore, who favor the idea of a central bank with a single head office, favor it because it grants just this power to dispose of the resources of the one section for the benefit of another, and must in consequence find themselves logically driven to a recognition of the view that such authority to transfer funds and to mass them at points where weakness has been indicated is properly to be exerted in the interest of the public. In the proposed bill, the exercise of such a power is subjected to restrictions which would manifestly and unquestionably make its use sporadic and exceptional, in so far as it resulted from the exercise of a power to compel the rediscounting of paper by one Federal reserve bank for another. Section 12, in specific terms, explains that the power is to be exerted only "in time of emergency" and by a unanimous vote of the reserve board. It, moreover, imposes a penalty charge of from 1 to 3 per cent upon the grant of such an accommodation. The power is clearly much less than that which has been advocated by friends of the central bank idea, inasmuch as it suggests an exceptional or occasional resort to an expedient which would be the staple of everyday business under a central banking plan, such as that proposed by the National Monetary Commission. The other side of the function --that of permitting Federal reserve banks to rediscount for one another—has also been objected to on the ground that such banks should be allowed to deal with one another freely if they choose. The committee does not concede this view, but believes that the banks should not thus be allowed to deal with one another except under oversight, in view of their distinct character as reserve holders.

(*c*) Paragraph (*c*) grants the Federal reserve board the power to suspend the reserve requirements of the act for designated periods if in its judgment such action may be deemed wise. There is nothing unusual or revolutionary in this requirement, it being in practice somewhat akin to the power granted the Comptroller of the Currency in section 5191, Revised Statutes, where he is practically able to permit national banks to go below their reserve for 30 days. In practice this power is constantly exercised by him subject to his judgment. The power is suggested by the process of "suspending the bank act" in England, and is a desirable administrative function in every case where a fixed reserve requirement is employed.

(*d*) The power to supervise and regulate the retirement of Federal reserve notes granted in this paragraph is of course a necessary concomitant to Government control of note issues, a matter to be discussed in detail in connection with the provisions for note issue.

(*e*) In paragraphs (*e*), (*f*), (*g*), (*h*), and (*i*) are conveyed powers which are largely self-explanatory and about which there can be little or no question, granting the general idea of effective Government oversight through a Federal reserve board or some similar organization.

In view of the fact that the Federal reserve board is vested with functions other than those formally enumerated in section 12, it may be worth while to list the chief powers conferred upon the board by the act as follows:

POWERS OF THE FEDERAL RESERVE BOARD.

To readjust districts created by the organization committee and create new ones, acting upon a joint application made by 10 of the national banks within an existing district.

To regulate the establishment of branches of Federal reserve banks within Federal reserve district in which bank is located.

To designate three (class C) of the nine members of the board of directors of each Federal reserve bank, one of these to be chairman of the board with the title of "Federal reserve agent."

The Federal reserve agent to maintain a local office of the Federal reserve board on the premises of the Federal reserve bank. He shall make regular reports to Federal reserve board and be its official representative.

To remove any director of class B (business men) if it should appear that he does not fairly represent the commercial, agricultural, or industrial interests of his district.

To remove chairman of Federal reserve bank without notice.

To establish by-laws governing applications from State banks and trust companies.

"Of the four persons * * * appointed (by the President), one shall be designated manager and one vice manager of the Federal reserve board." The manager, subject to supervision of the Secretary of the Treasury and board, shall be the active managing officer of the Federal reserve board.

To levy a semiannual assessment upon the Federal reserve banks for estimated expenses for succeeding six months, together with deficit carried forward.

To examine at its discretion the accounts, books, and affairs of each Federal reserve bank and to require such statements and reports as it may deem necessary.

To require, or on application to permit, a Federal reserve bank to rediscount the paper of any other Federal reserve bank.

To suspend, for a period not exceeding 30 days (and to renew such suspension for periods not to exceed 15 days), any and every reserve requirement specified in this act.

To supervise and regulate the issue and retirement of Treasury notes to Federal reserve banks.

To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section 21 of this act, or to reclassify existing reserve or central reserve cities and to designate the banks therein situated as country banks, at its discretion.

To require the removal of officials of Federal reserve banks for incompetency, dereliction of duty, fraud, or deceit.

To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks.

To suspend the further operations of any Federal reserve bank and appoint a receiver therefor.

To perform the duties, functions, or services specified or implied in this act.

To determine or define (subject to stipulations) the character of paper eligible for discount for member banks.

To prescribe regulations for purchase and sale by Federal reserve banks of bankers' bills, etc.

To review and determine the minimum rate of discount established by Federal reserve banks.

To authorize establishment of branches of Federal reserve banks in foreign countries.

To authorize the issue of Federal reserve Treasury notes.

To receive, through the local Federal reserve agent, applications from Federal reserve banks for notes, such applications to be accompanied by rediscounted notes for deposit as collateral security.

To require Federal reserve bank to maintain deposit in money of 5 per cent of notes issued.

To grant in whole or in part or to reject entirely the application from Federal reserve bank for notes.

To establish rate of interest on notes issued.

To prescribe regulations for substitution of collateral.

To make and promulgate regulations governing the transfer of funds at par among Federal reserve banks.

To act, if desired, as clearing house for Federal reserve banks.

To require, in its discretion, Federal reserve banks to act as clearing houses for shareholding banks.

To prescribe regulations for the recall and redemption of all national-bank notes outstanding after 20 years.

To require extra examinations of national banks when deemed necessary.

To determine and report annually to Congress fixed salaries of all bank examiners.

To assess upon banks in proportion to assets or resources the expenses of examinations.

To fix a date for such assessment.

To arrange for special or periodical examinations of member banks for account of Federal reserve banks.

To receive from Federal reserve banks information concerning the condition of any national bank in its district.

To order examinations of national banks in reserve cities as often as necessary, not less than four times a year.

To add to the list of cities in which national banks shall not be permitted to loan on real estate as described.

To receive applications from national banks having $1,000,000 or more capital for the establishment of branches in foreign countries, to reject or accept such applications, and to prescribe conditions under which such branches may be opened.

To require examinations of foreign branches as it may deem best.

To regulate savings departments of national banks and to prescribe their investments.

SECTION 13.

Section 13 provides for the creation of a Federal advisory council which is to consist of as many members as there are Federal reserve districts, each such district electing through the board of directors of its Federal reserve bank a representative of that bank. The functions of this board are wholly advisory and it would amount merely to a means of expressing banking opinion, informing the reserve board of conditions of credit in the several districts, and serving as a source of information upon which the board may draw in case of necessity. The desirability of such a body as a source of information and counsel is obvious, and it is believed that it gives to the banking interests of the several districts ample power to make their views known, and, so far as they deserve acceptance, to secure such acceptance.

SECTION 14.

In section 14 is set forth the fundamental business purpose of the bill in providing for rediscount operations. The Federal reserve banks are at the outset authorized to receive current deposits from their stockholders or from the Government or from other Federal reserve banks in so far as the latter may need to keep funds with them for exchange purposes.

The fundamental requirement throughout all of the discount section of the proposed bill is that antecedent to the performance of a service by a Federal reserve bank for a member bank which applies therefor the member bank shall indorse or guarantee the obligations which it offers for rediscount. Subject to this requirement, the proposed bill first of all provides that notes and bills having a maturity of not over 90 days and drawn for agricultural, industrial, or commercial purposes or the proceeds of which have been used for such purposes shall be admitted to rediscount. The meaning of this provision is briefly that any paper drawn for a legitimate business purpose of any kind may be rediscounted when within 90 days of maturity. It does not mean that the paper thus rediscounted shall have been originally made for 90 days, but that it shall have at the time of being rediscounted 90 days more to run. Thus a paper drawn for 120 days originally could be rediscounted when it was 30 days old. In view of the great difficulty of defining "commercial paper," the actual definition of the same has been left to the Federal reserve board in order that it may adjust the definition to the practices prevailing in different parts of the country in regard to the transaction of business and the making of paper. For obvious reasons it is forbidden that any such paper shall be admitted to rediscount if made for the purpose of carrying stocks or bonds.

It was felt that in some parts of the country the permission to rediscount paper having a maturity of 90 days might not fulfill all of the requirements imposed by the business practice of those regions, and therefore it is provided in the third paragraph of section 14 that, whenever the reserve of any Federal reserve bank is reasonably above its required minimum (such excess margin to be determined by the Federal reserve board), the reserve bank may rediscount commercial paper having a maturity of not more than 120 days, provided that not more than one-half of it shall have a maturity exceeding 90 days. This is intended to fulfill the requirements of portions of the country with an extremely long term of credit, but it is clear that no reserve banks should be allowed to put its funds into a form in which they will be "tied up" to such an extent, unless such a bank has a reserve perfectly adequate to take care of any necessities that are likely to present themselves in the meantime.

The fourth paragraph of section 14 grants permission to reserve banks to rediscount acceptances of member banks which are based on the exportation or importation of goods, run not more than six months, and bear the signature of one member bank in addition to that of the acceptor, the total of such rediscounts not to exceed one-half the capital of the bank for which the rediscounts are made. In the sixth paragaph, national banks are authorized to accept drafts or bills of exchange drawn upon it to an amount not exceeding one-half its capital. The acceptance business, which it is thus proposed to authorize, is a new form of business heretofore forbidden to national banks, by reason of the provisions and interpretations of the national-banking act, which have forbidden them to lend their credit or to incur contingent liabilities thereby. The acceptance form of loan is, however, very common in Europe, and has been found exceedingly serviceable. It is the opinion of expert bankers that it could be applied in the United States to excellent advantage. The following extract from a discussion of acceptances by Lawrence Merton Jacobs explains the method and purpose of the acceptance business:

"The fundamental difference between European and American banking has its origin in the dissimilarity between the evidences of indebtedness which lie behind the item of loans and discounts. It is most strikingly evidenced in the fact that time bills of exchange form a considerable proportion of the resources of the great banks of London, Paris, and Berlin, whereas the assets of leading New York banks are largely based on stocks and bonds.

"Of the bills of exchange in which are employed, either through loans or discounts, the funds of European banks, an essential part consists of what are known as bankers' bills—that is, bills drawn on bankers and accepted by them on behalf of customers in accordance with arrangements previously made. They are bills in exchange for which, by sale to a broker or by discounting at a bank, bankers' customers or those to whom they are indebted may secure immediate credit. In some instances it is arranged that the customers themselves shall draw the bills and in others that the bills shall be drawn by third parties for their account. In granting the accommodation the obligation that the bankers take upon themselves is that they will accept the bills upon presentation. This acceptance consists in the bankers writing across the face of the drafts the word "Accepted," adding their signature and the date. It is in the nature of a certification that the bills will be paid at maturity—that is, a specified number of days or months from the date appearing in the acceptance, or three days later if grace is allowed, as in England. When a banker grants accommodation to a customer by means of an acceptance he may secure himself in various ways. Ordinarily a banker accepts a customer's draft merely upon his general responsibility, the banker's risk being much the same as if he had discounted the customer's note running a certain length of time. Where the customer is an importer the banker ordinarily accepts the drafts upon the delivery to him of the documents covering the shipment, which documents he then turns over to his customer against a trust receipt. When a credit of this kind is opened the usual practice is for the banker to require the signature of a form containing an agreement to hold him harmless for accepting the bills, to place him in funds sufficient to pay off the bills three days prior to their maturity, and to pay him a commission on the transaction, this commission varying according to the length of time the bills are to run and the financial standing of the customer. The cost of the accommodation to the customer in this commission plus the prevailing rate of discount for bankers' bills.

"In the United States the national-bank act does not permit banks to accept time bills drawn on them. Although the act does not specifically prohibit such acceptances, the courts have decided that national banks have no power to make them. This restriction has had a very considerable influence upon the development of banking in this country. For some time after the passage of the national-bank act, merchants and manufacturers provided themselves with funds by discounting their promissory notes with their local banker. Gradually, however, many concerns, finding that their needs were outstripping the banking accommodation which they could secure in their immediate vicinity, came to place their notes in the hands of brokers who in turn disposed of them to such bankers as possessed greater surpluses than they could satisfactorily invest at home. It is this method of borrowing which is now largely employed. In other words, the prohibition of bank acceptances has led to the creation of a vast amount of promissory notes instead of time bills of exchange. The difference between these two classes of instruments accounts to a great extent for the difference between European and American banking. In the case of time bills of exchange drawn on and accepted by prime banks and bankers there is practical uniformity of security. In the case of our promissory notes or commercial paper there is no such uniformity, the strength of the paper depending on the standing of miscellaneous mercantile and industrial concerns.

"It is this uniformity of security on the one hand which makes possible a public discount market; it is the lack of it in single-name paper which makes such a market impossible. As a result, we have great discount markets in London, Paris, and Berlin, and none in New York. In European centers the discount rate is the rate upon which the eyes of the financial community are fixed. In New York it is the rate for day-to-day loans on the stock exchange. The advantage in character of the one rate over the other clearly indicates an important advantage of European banking systems over our own. In the first place, the European discount rate bears a very direct relation to trade conditions. Its fluctuations depend primarily on the demand for and supply of bills which owe their origin to trade transactions, as balanced against the demand for and supply of money. If trade is active, the supply of bills becomes large, rapidly absorbing the loanable funds of the banks. As these surplus funds become less and less banks are unwilling to discout except at advanced rates. If trade is slack, less accommodation from bankers in the way of acceptances is required, bills become fewer in number, the competition for them in the discount market more keen, and the rate of discount declines. Low rates are an incentive to business and advancing rates act as a natural check. The New York call-loan rate, on the other hand, bears only an indirect relation to trade conditions. Its day-to-day fluctuations register mainly the speculative and investment demand for stocks. Low rates, instead of being an incentive to the revival of trade, are rather made the basis for speculative operations in securities.

"The striking difference, however, between European discount rates and the New York call-loan rates is that the former are comparatively stable and the latter subject to most violent oscillations. Foreign discount rates as bank reserves become depleted advance by fractions of 1 per cent. In New York the money rate advances on occasion 10 per cent at a time, mounting by leaps and bounds from 20 per cent to 100 per cent in times of stress."

AMOUNT OF REDISCOUNTS.

There has been extensive conjecture as to the probable amount of business which could be done by the Federal reserve banks under the foregoing provisions and regarding the amount of paper likely to be presented by the banks for rediscount. Such conjecture is more or less profitless, for two reasons:

1. The rediscount business done in the United States heretofore has been small, partly because of the limitations of the national-bank act and partly because of the prejudice against borrowing by banks, which has more or less artificially sprung up.

2. The purpose of the new act is to develop a commercial paper market, and if successful in this endeavor the legislation will entirely transform the conditions under which paper is bought and sold, loans contracted between banks, and funds transferred from one part of the country to another.

While it is thus true that the facts as to existing conditions do not throw much light upon what is to be expected and that conjectures based upon them are futile, it is worth while to call attention to the following table, taken from the last annual report of the Comptroller of the Currency, which gives a compact survey of the classes of paper which might theoretically be available for rediscount under the provisions of the act as already explained:

1	2	3	4	5	6	7	8
Date.	Number of banks.	On demand, paper with one or more individual or firm names.	On demand, secured by stocks, bonds, and other personal securities.	On time, paper with two or more individual or firm names.	On time, single-name paper (one person or firm) without other security.	On time, secured by stocks, bonds, and other personal securities, or on mortgages or other real estate security.	Total.
		Millions.	*Millions.*	*Millions.*	*Millions.*	*Millions.*	*Millions.*
Sept. 15, 1902	4, 601	$237. 3	$706. 9	$1, 176. 4	$517. 1	$642. 4	$3, 280. 1
Sept. 9, 1903	5, 042	283. 1	717. 3	1, 267. 5	558. 1	655. 4	3, 481. 4
Sept. 6, 1904	5, 412	279. 8	818. 9	1, 316. 7	611. 0	699. 7	3, 726. 2
Aug. 25, 1905	5, 757	320. 1	854. 1	1, 382. 2	689. 1	753. 0	3, 998. 5
Sept. 4, 1906	6, 137	374. 7	828. 0	1, 502. 0	776. 1	818. 1	4, 299. 0
Aug. 22, 1907	6, 544	428. 2	832. 9	1, 648. 7	899. 5	869. 2	4, 678. 5
Sept. 23, 1908	6, 853	395. 9	922. 7	1, 582. 4	852. 1	997. 5	4, 750. 6
Sept. 1, 1909	6, 977	441. 5	957. 3	1. 698. 4	971. 5	1, 060. 1	5, 128. 8
Sept. 1, 1910	7, 173	524. 3	939. 1	1, 842. 5	1, 008. 3	1, 093. 0	5, 467. 2
June 7, 1911	7, 277	529. 7	953. 8	1, 885. 1	1, 124. 7	1, 117. 5	5, 610. 8
June 14, 1912	7, 372	571. 3	985. 4	1, 973. 4	1, 198. 5	1, 225. 3	5, 953. 9

The columns numbered 3, 5, and 6 are those which represent paper potentially available under the act.

The fifth paragraph of section 14 forbids the rediscounting for any one bank of an aggregate of notes and bills bearing the signature or indorsement of any one person or concern, this being a repetition of the prohibition of similar kind which is contained in the national banking act. A new feature is, however, found in the last sentence of the paragraph in question which reads as follows: "But this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values." This exception or exemption has long been asked for in the interest of legitimate business transactions. Obviously when a bill of exchange is secured by bills of lading and other documents accompanying it, it is primarily dependent for liquidation upon this unquestionably marketable wealth. There is therefore no reason for limiting the amount of the discount to be granted by any reference to the resources of the person applying for the accommodation or by the capital and surplus of the bank granting the discount, that being merely a question of banking judgment, while the bill itself is salable and will presumably be protected at the point where it is presented.

Summing up the terms of section 14, therefore, it may be said that the section simply applies to the Federal reserve banks the same general grants of authority and limitations thereon carried in the national-bank act with respect to the national banks, except that it more carefully limits the length of the paper to be rediscounted and the purpose for which it is drawn, while it opens the acceptance business to national banks and permits the rediscount of acceptance paper. The latter class of paper is limited to export and import operations in order to prevent any possibility of undue use of the provision at first by banks not thoroughly conversant with the working of the idea owing to lack of experience with this type of credit.

SECTION 15.

It will have been observed that the transactions authorized in section 14 were entirely of a nature originating with member banks and involving a rediscount operation. It is clearly necessary to extend the permitted transactions of the Federal reserve banks beyond this very narrow scope for two reasons:

1. The desirability of enabling Federal reserve banks to make their rate of discount effective in the general market at those times and under those conditions when rediscounts were slack and when therefore there might have been accumulation of funds in the reserve banks without any motive on the part of member banks to apply for rediscounts or perhaps with a strong motive on their part not to do so.

2. The desirability of opening an outlet through which the funds of Federal reserve banks might be profitably used at times when it was sought to facilitate transactions in foreign exchange or to regulate gold movements.

In order to attain these ends it is deemed wise to allow a reserve bank, first of all, to buy and sell from anyone whom it chooses the classes of bills which it is authorized to rediscount. The reserve bank evidently would not do this unless it should be in a position which, as already stated, furnished a strong motive for so doing. Outright purchases in the open market would of course require the payment of the face of the paper less discount, whereas rediscount operations would require simply the holding of a reserve of 33⅓ per cent behind the notes issued or deposit accounts created in the course of the rediscount operation. Apart from this fundamental permission, it was deemed wise to allow the banks to buy coin and bullion and borrow or loan thereon and to deal in Government bonds. The power granted in subsection (d) to fix a rate of discount is an obvious incident to the existence of the reserve banks, but the power has been vested in the Federal reserve board to review this rate of discount when fixed by the local reserve bank at its discretion. This is intended to provide against the possibility that the local bank might be establishing a dangerously low rate of interest, which the reserve board, familiar as it would be with credit conditions throughout the country, would deem best to raise.

The final power to open and maintaining banking accounts in foreign countries for the purpose of dealing in exchange and of buying foreign bills is necessary in order to enable a reserve bank to exercise its full power in controlling gold movements and in facilitating payments and collections abroad.

SECTION 16.

Section 16 provides for the transfer of all moneys now held in the general fund of the Treasury to the reserve banks, disbursements to be thereafter made by check upon such banks. The general philosophy of this proposed change and the conditions which imperatively demand it have been sufficiently sketched at an earlier point in this report, and it is only necessary here to examine the actual working of the provision. Twelve months are allowed to effect the transfer, this being deemed a sufficient time in view of the comparatively low state of the Government's deposits in banks to-day. The apportionment of the funds between banks is required to be made as equitably as possible between the different sections of the country, this proviso being practically a repetition of the language found in the national-bank act to-day. The Federal reserve board and the Secretary of the Treasury are left with full power to fix a rate of interest from month to month on the deposits, this to be not less than one-half of 1 per cent.

How large a transfer of funds would be effected under the terms of this provision, and how such a transfer would affect the Treasury itself, will depend upon the condition of the Treasury at the time of the passage of the act, but an approximate idea may be formed from the daily Treasury statement, a copy of which is hereto appended.

SECTION 17.

The subject of note issue has occasioned the committee no little concern, but after due and full consideration it has determined that the proper mode of note issue to be provided for in the proposed act is that of an issue of government Treasury notes, obligations of the United States and receivable for all taxes, customs, and other public dues. Recognizing that the country is now definitely committed to the immediate redemption of all existing paper currency in lawfu money, upon demand, the proposed measure requires the redemption of such notes both at the Treasury and at each of the Federal reserve banks at par when requested.

Recognizing, moreover, that the regulation of the volume of currency in circulation—as distinct from the underlying money of ultimate redemption—is a delicate function requiring to be adjusted in accordance with the commercial, agricultural, and industrial needs of the country, the power of getting out the notes by making application for them is by the bill given to Federal reserve banks, they being required to furnish the local Federal reserve agent with collateral security consisting of rediscounted notes and bills to a sum equal to the amount of the notes issued to the Federal reserve bank in question. These operations, connected with the issue and retirement of reserve notes, are to be carried on through the local Federal reserve agent, who is daily to notify the reserve board of issues and withdrawals. Such reserve notes are required to be protected by a specially segregated reserve fund of 33⅓ per cent in lawful money.

The mode of protecting the notes is an essential and fundamental element in this section of the bill. A first lien on all assets and a Government guaranty of the goodness of the notes obtained by making them liabilities of the United States render the security behind the issue absolute, both as to immediate and as to ultimate conditions. It may thus be fairly said that the protection of the notes as distinct from their redemption is as follows: (1) Government promise to receive them and to be ultimately responsible for them; (2) first lien on all the assets of the bank issuing them; (3) direct lien on 100 per cent of prime paper specially selected and segregated for their protection; (4) claim on 33⅓ per cent of money drawn from the general funds of the bank and re-created as fast as notes are redeemed, that there may always be a special fund for the immediate protection of the issues.

While the notes are, under the new section, allowed to carry on their faces a letter and serial number distinguishing them from others, they are not suffered to bear the name of the bank through which they are issued, and the fundamental feature of this peculiar "Government" character is that they are required to be redeemed at the counter of every Federal reserve bank, no matter whether such bank has issued any notes, and no matter how many notes it may have issued. This signifies that every Federal reserve bank is a redemption agency for the whole of the issue, and the question at once arises, Out of what will such reserve bank redeem the notes should a great quantity be thrown in upon it? The section provides that such a bank may, if it chooses, (1) pay the notes out of the 33⅓ per cent fund of lawful money or gold held by it for the redemption of its own notes, re-creating such fund at once from any other funds held by it for its other liabilities, (2) charge the notes off against Government deposits held by it (and against which, of course, there is a reserve of 33⅓ per cent of lawful money), which would mean that such bank would at once send the redeemed notes to the Treasury and get back an equal amount of fresh Government deposits, or (3) present the notes presented to it for redemption, although issued by some other Federal reserve bank, to the Treasury for redemption. In either of these latter cases, of course, the result would be to throw on the Treasury the work of getting back the amount of the redeemed notes by sending them to the bank, through which they were originally issued. In addition to these provisions, of course, it is required in other sections of the bill that every bank in the system shall receive the notes on deposit at par, and that they shall be payable to the Government for taxes, dues, and other public requirements.

All this shows how the notes are protected and how they can easily be redeemed by a man who is desirous of getting lawful money for his notes without any cost to himself. There is little doubt that his interests under the provisions of the measure are quite thoroughly safeguarded. But there remains the general question whether the public requirement of elasticity has been met and provided for. Elasticity must be considered from two standpoints—that of expansion and that of contraction. As to expansion, the regulatory mechanism is the Federal reserve board, which is given the power to veto applications for notes. The board, however, can not issue notes unless they are applied for and accompanied by a tender of proper commercial paper. This at least seems to assure that they will not be hastily or rashly overissued. The contraction feature is more difficult. In attempting to guard against the danger that the notes might remain in circulation after the need for them had passed, the bill makes the following provisions: (1) The notes can not be used in bank reserves; (2) the notes are not to be legal tender; (3) the notes can not be paid out by any Federal reserve bank (when not at first issued by it) under penalty of a tax of 10 per cent on their face value; (4) every Federal reserve bank is directed, upon receiving the note of another reserve bank, to (*a*) either send it direct to the bank that issued it, (*b*) to send it to the Treasury, charging it off against deposits, or (*c*) to present it to the Treasury for redemption in lawful money. On the other hand the Treasury is directed when it gets such notes in ordinary receipts to have them redeemed out of a 5 per cent fund kept with the department for that purpose, and then to send them home for ultimate redemption. The belief is freely expressed that these provisions will maintain the notes at par everywhere and will also prevent them from expanding or remaining out after the need for them has gone by.

There is a final paragraph in section 17 relating to the collection at par and without charge for exchange of certain classes of checks. The provision is that every Federal reserve bank shall receive on deposit at par the following classes of items:

1. Checks and drafts drawn upon any of its depositors.
2. Checks and drafts drawn by any of its depositors upon any other depositor.
3. Checks and drafts drawn by any depositor in any other Federal reserve bank upon funds to its credit in such reserve bank.

The object of these provisions is twofold:

1. To establish par transfers of funds among the banks in each Federal reserve district.
2. To establish par transfers of funds between Federal reserve districts.

Precisely how much difficulty and cost will be incurred by the Federal reserve banks in carrying out the provisions of this section can not be precisely calculated. It can, however, be positively stated that such expenditures will be very much less than those incurred by banks at the present day in carrying through their exchanges. The proposed provision will eliminate the numerous and well-founded complaints of unjust charges for exchange; and, while it will prevent certain banks from profiting as they now do by exchange transactions, it will correspondingly benefit the community. The committee is well aware that the operation of this section will undoubtedly relieve some members of the community of greater burdens than others. It does not, however, consider the fact that some persons have been suffering an unnecessary burden under existing circumstances, a good reason for refusing or failing to provide for an important public function.

That this function of exchange may be effectively carried out, and that other duties connected with relations between the several banks of the system may be wisely, promptly, and effectively carried through, the proposed bill confers upon the Federal reserve board the power to require each Federal reserve bank to perform the functions of a clearing house, and at its discretion to require some one of them to act as a clearing house for all the others or at its own discretion to act as a clearing house in this way itself.

SECTIONS 18 AND 19.

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 issue 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.
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.

It will be seen that the only interference with the existing demand for bonds provided under these sections is the withdrawal of the compulsory bond purchase now required. Precisely how great a limitation of the bond demand this would furnish can not be precisely stated. For the last year for which full report was made by the Comptroller of the Currency (1912) the net amount of bonds purchased by national banks to protect circulation was about $16,000,000. This, however, was far in excess of the amount of bonds necessarily to be purchased under the compulsory-purchase requirement, inasmuch as many banks bought more bonds than they were obliged to secure under the terms of the national-bank act. There is no reason why this demand for bonds should not continue, as in fact it undoubtedly will. The capitalization of banks organized in the year in question was $16,080,000, while the amount of bonds purchased was about the same. If the amount of bonds required to be purchased be assumed to have been 25 per cent of the face of the capital of the newly organized banks it would have been $4,000,000, and this may be taken as considerably above the amount of compulsory demand for bonds for which there will no longer be legal basis should the present bill be enacted into law. As against this the Government stands ready to redeem in the form of 3 per cent bonds, roughly speaking, $37,000,000 per annum, and it is only reasonable to suppose that under the most unfavorable conditions the quantity of 2 per cent bonds which wi l be converted into threes in this way will be far in excess of the amount of the compulsory demand for twos which is now cut off.

The future of the 3 per cent bonds, should the conversions go on at the rate of 5 per cent per annum, may be open to some question. The committee has, however, consulted able expert opinion upon this subject and has found a practical unanimity of view to the effect that at least $50,000,000 per annum in 3 per cent bonds can and will be absorbed in the United States at par. Should such prove not to be the case, the banks have only to retain their present bonds and continue the issue of circulation thereon, but it is confidently believed that no such situation will occur. The committee looks forward with assurance to the conversion of a very considerable percentage, if not all, of the permitted 5 per cent in each successive year during the earlier part at least of the 20-year period. As the 20-year period draws toward a close it is quite likely that some bondholders will prefer to hold their bonds for redemption, but in the meantime there will have been a sufficient retirement of national-bank notes to impart to the new currency to be put out through the Federal reserve banks the desired quality of elasticity. In order to improve the market for the 3 per cent bonds, section 19 provides that they are to be free from all taxation both as to income and principal. It will be remembered that the status of the bonds is further helped in some measure by the provision made in the earning section (sec. 7) for devoting the Government share of reserve bank earnings to the redemption of bonds. As a corollary of the bond-refunding plan and of the note section the committee has deemed it wise to insert in section 19 a prohibition upon the further use of the extra-legal substitutes for circulating notes which have heretofore done duty in times of panic under the form of clearing-house certificates, cashiers' checks, and various substitutes for actual money which have been illegally paid out by banks to their creditors in lieu of the payment in the usual forms of currency employed by them during normal times. No such expedients would have been permitted save under severe stress, and with a suitable provision for an elastic note issue based upon commercial paper they should not longer be suffered to continue in use.

The amount of 2 per cent and other bonds now held behind circulation and affected by the provisions of sections 18 and 19 may be recapitulated as follows:

Bonds held in trust for national banks, Sept. 2, 1913.

	Kind of bonds.	Rate of interest.	Total amount outstanding.	Bonds held for national banks.			
				Total.	To secure circulation.	To secure deposits of public moneys.	
						Value at par.	Value at rate approved by department.
	GOVERNMENT.						
I.	U. S. loan of 1925..at par..	4	$118,489,900	$37,669,460	$34,181,700	$3,487,700	$3,487,700
I.	U. S. loan of 1908-1918, at par..................	3	63,945,460	25,828,900	22,182,200	3,646,700	3,646,700
I.	U. S. Panama of 1961, at par....................	3	50,000,000	17,110,200	....	17,110,200	17,110,200
I.	U. S. consol of 1930.at par..	2	646,250,150	615,921,100	603,773,900	12,147,200	12,147,200
I.	U. S. Panama of 1936, at par....................	2	54,631,980	54,242,360	52,962,860	1,279,500	1,279,500
I.	U. S. Panama of 1938, at par....................	2	30,000,000	29,444,140	28,897,140	547,000	547,000
II.	Philippine loans...at par..	4	16,000,000	5,967,000	....	5,967,000	5,967,000
II.	Porto Rico loans....do....	4	5,225,000	1,821,000	....	1,821,000	1,821,000
II.	District of Columbia.do....	3.65	6,970,650	933,000	....	933,000	933,000
II.	Territory of Hawaii, 3½ per cent bonds at 90 per cent of par; all other Hawaiian bonds at market value, not exceeding par.	(1)	6,515,000	1,978,000	....	1,978,000	1,930,900
	MISCELLANEOUS.						
III.	Philippine Railway Co....	4	8,551,000	898,000	....	898,000	598,571
III.	Manila Railroad Co........	4	6,735,000	10,000	....	10,000	6,750
III.	At 90 per cent of market value, not exceeding 90 per cent par.						
IV.	State, county, city, and other securities [2]........	(1)	....	17,951,137	....	17,951,137	11,747,904
	Total..................	....	....	809,774,237	741,997,800	67,776,437	61,213,425

[1] Various.

[2] As security for deposits made in connection with crop movement Government bonds are accepted at par, other bonds at 75 per cent of market value, and commercial paper at 65 per cent of face value.

When banks have occasion to withdraw bonds held by the Treasurer to secure deposits of public moneys, the following shall be the order of withdrawal: Group IV, Group III, Group II, and Group I.

Bonds within a group may be interchanged by banks if desired, but bonds in a lower group may not be substituted for those in a higher group, except that an initial substitution of bonds of a lower group for those of a higher group may be made to an amount not to exceed 30 per cent of the total security value of bonds held for a particular bank. National-bank depositaries which have not as yet taken out the full amount of circulation authorized by law may withdraw United States 2s and substitute for them bonds in Group II, provided the 2s as withdrawn shall be used as security for additional circulation.

SECTION 20.

Section 20 seeks to readjust the reserve requirements now provided by the national banking act in such a way as to make them conform to the dictates of scientific banking, and to adjust them to the provisions of the proposed bill. The following main objects have been had in mind:

1. To abolish entirely the present system of redeposited or "pyramided" reserves.
2. To establish a moderate required reserve actually to be held in cash in the vaults of the banks.
3. To prescribe a secondary reserve to take the form of a credit with the Federal reserve banks.

Several serious problems at once suggest themselves as the result of any effort to attain these objects. In the first place, the present conditions have grown up over a period of 50 years, and it is not desirable, even if it were safe, to disturb them roughly. Secondly, it is considered that existing reserve requirements, being based upon the state of affairs in which many independent banks were working without coordination it is possible to reduce the actual amount of reserves to be held. Finally, it is noted that in making the change suggested careful account must be taken of the total sums in cash as distinct from those in balances required to be held by existing law, and that they should be contrasted with the sums in cash and balances prescribed under the proposed bill. In surveying the situation a beginning may be made by considering with care the reserve requirements of the national bank act. These are as follows:

RESERVE CITIES AND RESERVE REQUIREMENTS.

120. SEC. 5191. Every national banking association in either of the following cities, Albany, Baltimore, Boston, Cincinnati, Chicago, Cleveland, Detroit, Louisville, Milwaukee, New Orleans, New York, Philadelphia, Pittsburg, St. Louis, San Francisco, and Washington, shall at all times have on hand, in lawful money of the United States, an amount equal to at least twenty-five per centum of the aggregate amount of [*its notes in circulation and*] its deposits; and every other association shall at all times have on hand, in lawful money of the United States, an amount equal to at least fifteen per centum of the aggregate amount [*of its notes in circulation and*] of its deposits. Whenever the lawful money of any association in any of the cities named shall be below the amount of twenty-five per centum of its [*circulation and*] deposits, and whenever the lawful money of any other association shall be below fifteen per centum of its [*circulation and*] deposits, such association shall not increase its liabilities by making any new loans or discounts otherwise than by discounting or purchasing bills of exchange payable at sight, nor make any dividends of its profits until the required proportion, between the aggregate amount of its [*outstanding notes of circulation and*] deposits and its lawful money of the United States, has been restored. And the Comptroller of the Currency may notify any association whose lawful money reserve shall be below the amount above required to be kept on hand to make good such reserve; and if such association shall fail for thirty days thereafter so to make good its reserve of lawful money, the comptroller may, with the concurrence of the Secretary of the Treasury, appoint a receiver to wind up the business of the association, as provided in section fifty-two hundred and thirty-four.

NOTE.—This section is amended by the act of June 20, 1874, section 2, which provides that no reserve need be held against circulation. Said act follows section 5192. Act of March 3, 1903, amending act of March 3, 1887, providing for additional reserve cities, follows section 5192. Provisions relating to redemption of circulating notes, acts June 20, 1874, March 3, 1875, and July 14, 1890, follow Revised Statutes, 5192. Provisions relating to redemption of old notes of banks extending their corporate existence, act July 12, 1882, follows Revised Statutes, 5136. Leavenworth, Kansas, was included as a reserve city in the original act, but was struck out March 1, 1872. Words "lawful money" construed by Attorney General as including all that is legal tender. (Opin. Atty. Gen., 17; 123.)

WHAT MAY BE COUNTED AS RESERVE.

121. SEC. 5192. Three-fifths of the reserve of fifteen per centum required by the preceding section to be kept may consist of balances due to an association, available for the redemption of its circulating notes, from associations approved by the Comptroller of the Currency, organized under the act of June three, eighteen hundred and sixty-four, or under this title, and doing business in the cities of Albany, Baltimore, Boston, Charleston, Chicago, Cincinnati, Cleveland, Detroit, Louisville, Milwaukee, New Orleans, New York, Philadelphia, Pittsburg, Richmond, Saint Louis, San Francisco, and Washington. Clearing-house certificates, representing specie or lawful money specially deposited for the purpose, of any clearing-house association, shall also be deemed to be lawful money in the possession of any association belonging to such clearing house, holding and owning such certificate, within the preceding section.

NOTE.—Leavenworth, Kansas, was included as a reserve city in the original act but was struck out March 1, 1872. Charleston and Richmond not being included in the list of reserve cities enumerated in section 5191, the banks of which are required to hold a reserve of twenty-five per centum of their net deposits, the Comptroller of the Currency has never approved any banks in said cities as reserve agents.

LAWFUL MONEY RESERVE TO BE DETERMINED BY DEPOSITS. ACT JUNE 20, 1874.

122. SEC. 2. That section thirty-one of "the national-bank act" be so amended that the several associations therein provided for shall not hereafter be required to keep on hand any amount of money whatever, by reason of the amount of their respective circulations; but the moneys required by said section to be kept at all times on hand shall be determined by the amount of deposits in all respects, as provided for in the said section.

NOTE.—Section 31 of "the national-bank act" is incorporated in sections 5191, 5192, Revised Statutes. Section 1 of act June 20, 1874, precedes section 5133, Revised Statutes.

NO RESERVE NEED BE HELD AGAINST DEPOSITS OF PUBLIC MONEY. ACT MAY 30, 1908.

123. SEC. 14. That the provisions of section fifty-one hundred and ninety-one of the Revised Statutes, with reference to the reserves of national banking associations, shall not apply to deposits of public moneys by the United States in designated depositaries.

PROVISIONS FOR REDEEMING CIRCULATION—FIVE PER CENT REDEMPTION FUND ACT JUNE 20, 1874.

124. SEC. 3. That every association organized or to be organized under the provisions of the said act and of the several acts amendatory thereof shall at all times keep and have on deposit in the Treasury of the United States, in lawful money of the United States, a sum equal to five per centum of its circulation, to be held and used for the redemption of such circulation; which sum shall be counted as a part of its lawful reserve, as provided in section two of this act; and when the circulating notes of any such associations, assorted or unassorted, shall be presented for redemption, in sums of one thousand dollars, or any multiple thereof, to the Treasurer of the United States, the same shall be redeemed in 【*United States notes*】. All notes so redeemed shall be charged by the Treasurer of the United States to the respective associations issuing the same, and he shall notify them severally on the first day of each month, or oftener, at his discretion, of the amount of such redemptions; and whenever such redemptions for any association shall amount to the sum of five hundred dollars, such association so notified shall forthwith deposit with the Treasurer of the United States a sum in United States notes equal to the amount of its circulating notes so redeemed. And all notes of national banks worn, defaced, mutilated, or otherwise unfit for circulation shall, when received by any assistant treasurer, or at any designated depository of the United States to be forwarded to the Treasurer of the United States for redemption as provided herein. And when such redemptions have been so reimbursed, the circulating notes so redeemed shall be forwarded to the respective associations by which they were issued; but if any of such notes are worn, mutilated, defaced, or rendered otherwise unfit for use, they shall be forwarded

to the Comptroller of the Currency and destroyed and replaced as now provided by law: *Provided*, That each of said associations shall reimburse to the Treasury the charges for transportation and the costs for assorting such notes; and the associations hereafter organized shall also severally reimburse to the Treasury the cost of engraving such plates as shall be ordered by each association respectively; and the amount assessed upon each association shall be in proportion to the circulation redeemed, and be charged to the fund on deposit with the Treasurer: *And provided further*, That so much of section thirty-two of said national-bank act requiring or permitting the redemption of its circulating notes elsewhere than at its own counter, except as provided for in this section, is hereby repealed.

NOTE.—Section 12 of act of May 30, 1908, provides that notes of national banking associations shall be redeemed in lawful money of the United States. (See said section 12, page 49, ante.)
Section 32 of national-bank act is section 5195, Revised Statutes.

We may now contrast with the requirements which are thus laid down by existing national-bank legislation those which are established in the proposed legislation. In the following tabular view is given for each class of national banks—central reserve city, reserve city, and country—the provisions which it is proposed to create under the new legislation:

Reserve requirements.

COUNTRY BANKS.

	Up to 14 months.	14 months to 36 months.	After 36 months.
	Per cent.	*Per cent.*	*Per cent.*
Total reserve required	12	12	12
Cash in own vaults	5	5	5
On deposit with Federal reserve bank, required	3	5	5
On deposit in reserve or central reserve city or in Federal reserve bank or in cash, optional with bank	4	2	....
In cash or on deposit in Federal reserve bank, optional with bank	....	....	2
Total reserve	12	12	12

Date.—"From and after the date set by the Secretary of the Treasury and officially announced by him as hereinbefore provided."

Refers to.—"That within 60 days from and after the date when the Secretary of the Treasury shall have officially announced, * * * the fact that a Federal reserve bank has been established."

RESERVE CITY BANKS.

	60 days.	60 days to 14 months.	After 36 months.
	Per cent.	*Per cent.*	*Per cent.*
Total reserve required	20	18	18
Cash in own vaults	10	9	9
On deposit with Federal reserve bank, required	....	3	5
On deposit in central reserve city, optional with bank. May be cash or on deposit with Federal reserve bank	10	6	....
On deposit with Federal reserve bank or in cash, optional with bank (see note)	....	....	4
Total reserve	20	18	18

Date.—"From and after the date set by the Secretary of the Treasury for the incorporation of the Federal reserve bank."

Again.—"For 60 days from the date set by the Secretary for the organization of the reserve bank."

BANKS IN CENTRAL RESERVE CITIES.

	60 days.	60 days to 14 months.	After 14 months.
Total reserve required	20	18	18
Cash in own vault	10	9	9
On deposit with Federal reserve bank:			
Optional			
Required		3	5
On deposit with Federal reserve bank or in cash, optional with banks	10	6	4
Total reserve	20	18	18

Two questions present themselves in connection with these reserve requirements—the first, How far would the banks be able to comply with them without sacrifice; and the second, How far would this change seem to be desirable? These may be dealt with in the reverse order.

In outlining the general philosophy of the proposed banking bill it was pointed out that the existing system of redeposited reserves gives rise to cheap money for stock-exchange speculation in the centers while it fails to provide in times of panic a reserve upon which the country can draw with assurance, because at such times stock-exchange securities can not be easily liquidated, so that call loans are unavailable as a resource, and the city banks in self-defense have deemed themselves warranted in suspending specie payments. It is contended, however, that these difficulties and irregularities of the existing system are mere blemishes upon the surface of an otherwise desirable state of affairs, and that there is good and sufficient economic reason for maintaining the present system of redeposited reserves at least in part. This claim may be reduced to a series of propositions, as follows:

1. The redeposited reserves are placed with the city banks not for stock speculation, but in large measure at least to supply exchange funds upon which the depositing banks may draw.

2. The redeposited balances must be kept with the banks which now hold them, because the country banks look to these city banks for accommodation and the latter gauge the amount of accommodation to be granted them by the size of the balances.

3. The country banks, and in general all banks making the redeposits get a rate of interest thereon. They are thus able to make use of a reserve which would otherwise be "dead," and which when held in cash or in the Federal reserve banks will yield them no revenue, the latter banks being forbidden by the terms of the bill to pay interest on deposits.

These contentions are worthy of careful study, because they are widely urged.

Regarding the first point—the question of exchange funds—it will be noted that the proposed bill has met the requirement for such funds by specifically directing Federal reserve banks to receive specified classes of checks at par. It has thus largely wiped out the necessity for any such balance as now held. It may be noted, however, that there is in the bill nothing whatever to prevent the banks from maintaining any amount of such balances with city banks as they desire. Clearly if the balances with the city banks are exchange balances they are not reserves and there is no reason for regarding them as such.

The second point already noted has even less force than the first. Not only does the proposed bill provide more extensive facilities for rediscount than have ever been known, but even it if did not do so, and even if, as alleged, there are many kinds and classes of security not eligible for rediscount under the bill which country banks can use as a basis for accommodation only with city banks, it would still remain true that this does not afford any warrant for demanding the maintenance of the existing situation. The refusal to grant accommodation except in proportion to the amount of balance held by the would-be borrower is purely a matter of business practice. If a condition should be created under the proposed bill such that banks could not maintain the present reserve city deposits, it is hardly to be expected that the reserve city banks would immediately injure themselves and destroy their own source of business profits by refusing to buy good marketable paper or to extend loans upon sound security merely because conditions had altered and the large balances of former days were no longer kept with them.

As for the third contention—the loss of interest to depositing banks due to the sacrifice of their 2 per cent on reserve balances—the argument against the proposed change almost degenerates into absurdity. The measure so greatly broadens the scope of banking business as to open many new avenues of profitable investment, while the sacrifice of the 2 per cent now customarily paid is not only no loss to the community but represents the abolition of a long-standing evil which has drawn funds to places where they were not needed and away from those where they were.

In the ultimate analysis, the whole question simmers down to an issue whether the amount of reserve prescribed under the proposed bill is or is not excessive, and whether it can or can not be readily furnished by banks under the terms of the suggested legislation. The existing system is not backed either by the custom of other countries, by abstract logic, by the dictates of past experience, or by any other considerations. The only problem in the case is that of determining the correct amount of reserves to be required by the banks, and then of making the transition to the new basis under proper conditions.

The next step in the study of the proposed requirements is therefore an analysis of the ability of the banks to make the transition. The following computations may first be examined:

1. The bill provides in section 20 for a revision of the existing reserves of national banking associations.

2. The present reserve system recognizes three classes of banks: (*a*) Country banks, (*b*) reserve city banks, (*c*) central reserve city banks. Country banks are required to hold 6 per cent of their deposit liabilities in lawful money and may hold 9 per cent in balances with other banks. Reserve city banks are required to hold 12½ per cent of their deposits in lawful money and may hold 12½ per cent in balances with other banks in central reserve cities. Central reserve city banks are required to hold 25 per cent of their deposits (including those of other banks with them) in lawful money in their own vaults.

3. The bill aims to transfer these reserves away from banks other than those to which they belong, so that ultimately bank reserves will be held partly (*a*) in the vaults of the banks to which they belong and (*b*) partly in the reserve banks to be created under it, the reserve banks thus created taking the place of existing reserve city and central reserve city banks in their relation to others.

4. In carrying out this plan, the bill contemplates that ultimately reserves shall be as follows: (*a*) Five per cent of the outstanding deposits of all banks to be carried in the new reserve banks; (*b*) 5 per cent of the deposits of present country banks to be carried in cash in their own vaults; (*c*) 2 per cent of the deposits of present country banks to be carried either in cash in their own vaults or as a balance with new reserve banks; (*d*) 9 per cent of the deposits of present reserve city and central reserve city banks to be carried in cash in their own vaults; (*e*) 4 per cent of the deposits of present reserve city and central reserve city banks to be carried either in cash in their own vaults or as balances with the new reserve banks.

5. It is of course evident that the "balances" spoken of can be obtained by rediscounting paper with the new reserve banks.

6. From the foregoing it is clear that as some discretion is left to the banks about their reserves, the exact position of those reserves at any given time can not be predicted. Maximum and minimum limits can, however, be fixed. This is done as follows:

7. At the date of June 4, 1913 (comptroller's last report), the present bank reserve in central reserve cities was $409,601,424, held in cash.

At the same date the reserve which would have been required under the new plan as above sketched would have been 9 per cent of net deposits then subject to reserve requirements in cash and 9 per cent as a maximum in balances with the new reserve banks, as follows:

To be held in cash	$141,127,835
To be held as balances	141,127,835
Total	282,255,670

From this it is clear that if the balances under the new plan were established by taking actual money and putting it in the reserve banks the actual release of cash as compared with the present plan would be the difference between the total new reserve and the present reserve, while if the reserve balances were created by rediscounting the cash released under the new plan would be the difference between the cash required to be held under the new plan and the cash now actually held. That would signify:

Maximum release of cash	$268,473,589
Minimum release of cash	127,345,754

8. At the same date mentioned above the banking reserve in reserve cities as held by the banks was:

Held in cash	$250,383,926
Held in balances	232,799,679
Total	483,183,605

Under the new plan these banks would have to hold in cash 9 per cent of their net deposits subject to reserve requirements and a like amount in balances (maximum), which would be for the reserve cities as a group:

To be held in cash	$175, 128, 701
To be held in balances	175, 128, 701
Total	350, 257, 402

Comparing these figures with the present requirements, as already given, it is seen that the new plan might mean either a

Maximum release of cash	$75, 255, 225
Or a maximum contraction of cash	99, 973, 476

9. At the same date mentioned above the banking reserve in country banks was held as follows:

Held in cash	$289, 392, 177
Held in balances	310, 689, 129
Total	600, 081, 306

Under the new plan the cash required would be 5 per cent of their net deposits subject to reserve requirements and 7 per cent in balances (2 of this at the bank's discretion). This would mean:

To be held in cash	$180, 533, 642
To be held in balances	252, 747, 100
Total	433, 280, 742

On the same principles as before this would mean a maximum release or contraction as follows:

Maximum release	$108, 858, 535
Maximum contraction	143, 888, 565

10. Thus it appears that there would be a possible maximum contraction as follows:

Reserve city banks	$99, 973, 476
Country banks	143, 888, 565
Total	243, 862, 041
Deduct central reserve city release	127, 345, 754
Net contraction	116, 514, 287

It is also evident that the result might work out as follows:

Released by central reserve city banks	$268, 473, 589
Released by reserve city banks	75, 255, 225
Released by country banks	108, 858, 535
Total	452, 587, 349

11. Which of these results would probably be reached? Assume that the first (contraction) was the net result owing to banks fulfilling their reserve requirements by depositing cash in every instance. The Government balances which are now to be poured into trade channels through the new reserve banks will run from $200,000,000 to $250,000,000. Bearing in mind the fact that the capital of the new banks has to be raised in cash, it will be seen that allowing for $100,000,000 of this capital the monetary situation would be left about the same as it is to-day except that the new reserve banks would be in position to add their loaning power to that of the older

banks. If we now assume that the transfer of reserves resulted in the extreme limit of expansion already referred to, it would be noted that the cash is released only on the assumption that the new reserve banks have to hold one-third in lawful money in order to make these discounts, it is clear that only two-thirds of $452,587,349, or about $300,000,000, will be released. Of this sum a certain part would be needed in bringing the reserves of State banks which may become members of the new associations up to the level which is required of them. How much this would be can not be positively asserted.

12. If it be asserted that this process will lead to inflation, the answer to be made is that whether it will or not is a matter in the hands of the reserve banks which have it in their power by fixing their rate of discount suitably to prevent the banks from creating with them by rediscounting reserve balances in excess of the required 5 per cent. If the reserve banks should do this, it would be found that the required 5 per cent referred to would be about $356,000,000 while the amount which the banks at their option might or might not obtain in this way would be about $213,000,000, the actual cash required to be held by them under the new plan as already sketched, being as follows:

Central reserve city banks	$141,127,835
Reserve city banks	175,128,701
Country banks	180,533,642
Total	496,790,178

Add to this the amount which the reserve banks can at their option make it worth while for the other banks to hold in cash or to deposit with them in cash, and we have a total of about $710,000,000. The actual cash held to-day by the banks at home and in the redemption fund is about $950,000,000. Something like $240,000,000 would thus be released under the probable working out of the system, and this would be drawn upon for the other purposes already referred to.

IMMEDIATE SHIFTING OF FUNDS.

This review of the reserve requirements of the proposed bill is, however, based entirely upon a comparison of the situation as to reserves at the present time contrasted with the situation which will exist at the end of three years after the measure has gone completely into operation. It was deemed wise to allow this length of time, as has already been elsewhere noted, for the reason that there will necessarily be some readjustment of loans, and if the change were to be suddenly made it might result in temporary embarrassment for some banks. The committee has made very careful inquiry into the length of time that should be allowed for shifting reserve requirements in the way indicated, and the maximum period that has been asserted to be necessary was found to be three years. It is probable that the change could be effected in a very much shorter time than this, if it were necessary to bring it about more quickly, but the committee has deemed it best to allow the full period that was thought desirable by the most conservative reasoners whom it consulted. This three-year period was the maximum mentioned either in the public hearings or in communications sent to the committee by experts with reference to the subject.

There is, however, another phase of the question of transfer which has not yet been dealt with. A review of the reserve section will make it clear that a period of 60 days after the creation of the reserve banks is fixed, during which conditions are allowed to remain as they are if desired by city banks, but by the end of which it is required that a certain transfer of reserves shall have been made to the reserve banks. Inasmuch as it was thought that this transfer might be difficult for the banks unless they were granted relief to a corresponding extent, the bill provides for the reduction of the reserve requirements in reserve and central reserve cities from 25 to 18 per cent at the end of the 60-day period in question. An examination of the latest returns for banking condition made public by the comptroller as of June 4, 1913, and reproduced in the appendix of this report shows that the total net deposits subject to reserve requirements may be taken for purposes of discussion at $7,200,000,000. Three per cent of this amount is $216,000,000. This might be supplied either through actual transfer of cash from the banks which now hold it, or through the obtaining of rediscounts, or partly in one way or partly in the other. The committee, however, has endeavored to adjust the requirements of the bill so that the transfer could be made, as already stated, in actual cash without any inconvenience. The reserve banks of the central reserve cities have normally on hand about $400,000,000 of reserve money. Of this seven twenty-fifths would be released under the provision for reduction of reserves from 25 per cent to 18 per cent. Banks in reserve cities have normally about $250,000,000 in cash, and about an equal amount in balances with central reserve cities. The reduction of reserve requirements from 25 to 18 per cent would release seven twenty-fifths out of this amount, or 3½ per cent in balances and 3½ per cent in cash—roughly speaking, $70,000,000 in each form.

Now, let it be assumed that the banks undertake to comply with the requirement of a transfer of 3 per cent of their liabilities from existing reserve city and central reserve city banks to the new reserve banks. As an extreme illustration we may suppose that the country banks will draw for the amount in question on the reserve city banks. As the deposit liabilities of the country banks are about $3,600,000,000, it may be supposed that the call will require about $108,000,000. How would the reserve city banks supply this amount—assuming that the call was made upon them and not directly upon central reserve city banks? Presumably they would draw upon their New York correspondents, and upon other central reserve cities, unless by so doing they cut down the balances there below the figure necessary for them to hold in order to comply with reserve requirements. We have seen that they could spare only about 3½ per cent of their own outstanding deposits. It must be remembered, however, that they will themselves find it necessary to shift 3 per cent of their outstanding deposits to the reserve banks. In addition, then, to the total draft of $108,000,000 made upon them by the country banks, they will have to provide in order to meet their own requirements 3 per cent of about $2,000,000,000 or roughly speaking $60,000,000—a total requirement therefore of $168,000,000. Of this it is fair to suppose that 3½ per cent of their present deposits or fully $70,000,000 can be directly transferred in cash without damaging their position. Another $70,000,000 can be clipped from their balances with central reserve cities without unduly reducing the latter. There would thus be needed $28,000,000 to meet all demands in cash.

In connection with the foregoing computation, it should, however, be borne in mind that 1 per cent of cash has been released in the country banks by the reduction of the vault cash requirements from 6 to 5 per cent. Inasmuch as the total reserve requirements of country banks is cut to 12 per cent, it may perhaps be fair to suppose that this margin of cash could be drawn upon at the very outset in order to supply cash requirements. It would certainly before long furnish a means of extending discounts and would be available as a cash resource for the combined banks obviating the necessity of applying to the new reserve banks for rediscount accommodation.

It must, moreover, be borne in mind in the foregoing computations that by the process of withdrawing funds already referred to there has been a corresponding reduction of deposit liabilities, with a corresponding reduction of reserve requirements against them. For example, if the assumption that country banks draw upon reserve city banks for the full amount of their transfers to the new Federal reserve banks be correct, the effect would be to eliminate about $100,000,000 of deposits formerly held by reserve city banks against which reserves had to be carried but which having been paid off are no longer subject to reserve requirements. This would be a release under the new reserve provisions of $20,000,000 of reserve money in the reserve cities. The reserve thus released might be either in cash or balances and it is fair to assume would be about evenly divided between the two. In central reserve cities if a draft for $70,000,000 were made by reserve city banks the result would be a release of reserve against deposits to a corresponding extent, thereby enabling banks to reduce their necessary cash holdings by one-fifth of that amount, $14,000,000, at the outset and by a further 2 per cent additional later on.

Summing up these compensating or offsetting factors of the situation it is a fair conclusion that the draft upon the banks during the first 60 days' life of the new undertaking would be much less, so far as reserve requirements are concerned, than the demands made by present reserve requirements.

What has been said applies entirely to the first year under the new measure. At the end of that time an additional transfer of 2 per cent of deposit liabilities must be made by the member banks. Assuming that their deposits remain stationary during the year on the basis of the report of June 4, last, the amount needed to be transferred would be 2 per cent of about $6,900,000,000, or about $138,000,000. If the banks had not accumulated cash during the year or retained the surplus cash set free at the outset, this requirement might, so far as it consisted of an actual draft upon reserve and central reserve cities, have to be met by rediscounting. There is, however, no probability that any such situation would develop. On the contrary, the year's operations would have been marked by a far greater ease in the loan transactions of the banks than any previously experienced, due to the fact that the new reserve system was in operation. It is fair to suppose that the amount of deposits would have increased considerably and that the amount of reserve to be transferred would have correspondingly increased.

That in the meantime the habit of resorting to the reserve banks for rediscounts would have grown up can not be questioned. At the end of the year, therefore, the banks would simply be obliged to strengthen their balances with the reserve banks to the extent of $138,000,000, and they would do this through ordinary commercial processes involving no inconvenience or sacrifice whatever. If the extreme supposition that the banks did not enlarge their deposits during the year, and that the cash originally held against them remained stationary, should be accepted, the fact would remain that the reserve banks would during that period have received some $200,000,000 from the Government in cash deposits and would have paid out more or less of it, into circulation, inevitably resulting in increasing the flow of cash into the vaults of the member banks while they would still have a comfortable margin left from the first release. If the volume of loans were the same at the end of the year as at the beginning it would be practically inevitable that they should be very much stronger in cash than they are at present.

In closing this discussion of the relative strength of the banks before and after the transfer of reserves, it is well to emphasize once more the fact that the new requirements, far from causing constriction will cause relaxation and that the danger of the situation from the banking standpoint will not be in the limitation of loans but rather in the inflating of them—a process which, however, will remain well under the control of the reserve banks to be organized, by reason of their regulation of the rate of rediscount.

Throughout the foregoing computations, it should be understood, reference has been had to the most unfavorable conditions that could be supposed to exist and no effort has been made to put the situation in a light that would present the transition to the new system as unduly easy. There are two broad classes of considerations which, however, should be taken into account in studying the situation which would exist after the adoption of the proposed bill. These are as follows:

1. Many banks do not keep their permitted balances with banks in reserve cities, but with banks in central reserve cities. The result is that the total amount of drafts to be made upon reserve city banks will, in fact, be less than that which has already been computed and there will be less necessary shifting of balances under the operation of the bill in question.

2. It is not true that all banks would as assumed come into the new system within 60 days. The act is founded upon the provision that (*a*) within 90 days after the adoption of the act the organization committee shall designate places for the organization of reserve banks, and that (*b*) within 60 days after the date when the organization of a bank has been announced, there shall be a shift of a certain per cent in the reserves required. This would be a total of 150 days after the passage of the act which would be likely to elapse before the new reserve requirements would become effective. More important still, the new reserve banks can be organized in any district as soon as a capital of $5,000,000 each is assured. This would be $60,000,000 in all, so that even if reserve banks were simultaneously organized in all districts it would not be necessary for more than three-fifths of the banks to have signified an intention to enter the system. The banks are

given a year within which to settle for themselves whether they will enter the system or not. It is thus entirely possible, although we think not probable, that the organization of some of the reserve banks might be deferred until several months after the adoption of the act. If this should be the case the call for new reserves would be even slower and it is fair to assume that the movement of banks into the system will practically be distributed throughout the year so that the draft on reserve funds will not fall suddenly as has been assumed in the computations made above, but will be diffused over a very considerable period. This would give ample opportunity for the acquiring of reserve money through any one of the channels through which it is ordinarily obtained—importation, production of gold, the gathering in of cash in circulation, or as a substitute the gradual extension of rediscounts by Federal reserve banks which count for reserve purposes the same as actual cash, up to the specified limit permitted by the act. There need therefore be no anxiety whatever with reference to a sudden stringency due to an excessive demand for currency consequent upon a rush of banks into the new system immediately after the enactment of the proposed legislation. On the contrary, the reasonable expectation would point in the opposite direction—toward a somewhat extensive relaxation of cash requirements due to the fact that banks will see a profit in getting rediscounts from the Federal reserve banks instead of fulfilling their reserve requirements by transferring actual reserve money to such banks. This is quite opposed, we are aware, to the current view on this subject, but it is far more in harmony with the facts of the case.

SECTION 21.

In this section provision is made for the repeal of portions of existing law which require that the 5 per cent fund deposited with the Treasurer of the United States by national banking associations for the purpose of note redemption shall be counted as part of the lawful reserve. There is no good reason for treating the 5 per cent fund in this way and there never has been any. The existing requirements of legislation practically withdraw the amount kept with the Treasury for the purpose of current redemption of national bank notes from the actual uses of the bank and put them out of reach. It is believed that if the national banks are to continue to issue notes, and so long as they do, they should be required to provide for the redemption of their notes on an independent basis, and that the fiction of counting as reserve something which is not reserve and never can serve that purpose ought not to be maintained. As the national-bank notes are retired, through the presentation of 2 per cent bonds for conversion into threes, the amount of the fund kept on deposit with the Treasury for the current redemption of national-bank notes will be of less and less importance, so that such burden as is thrown upon the banks by the provisions of section 21 will disappear as the banks at their own option convert their bonds. The section is therefore a further working out of the ideas carried by section 20, which are in substance that reserve should be either actual cash at home or a balance with a cooperative institution which is organized for the purpose of maintaining and safeguarding the solvency of the country and which can be relied upon to hold its balances subject to call in case of necessity.

SECTION 22.

Section 22 establishes a reserve of $33\frac{1}{3}$ per cent of the outstanding demand liabilities of each Federal reserve bank, such reserve to be held in gold or lawful money. In a general way the committee believes that requirement of a fixed reserve is not a wise or desirable thing as viewed in the light of scientific banking principle. It believes, however, that in a country accustomed to fixed reserve requirements the prescription of a minimum reserve may have a beneficial effect, and it therefore has determined upon $33\frac{1}{3}$ per cent. This it regards as a minimum requirement and it firmly believes that the reserve banks will of their own accord keep as a usual practice considerably more than the amount required. It will be remembered that in an earlier section (sec. 12) the Federal reserve board was given power to suspend reserve requirements for 30 days if it saw fit. And in the present section, with that in mind, it is provided that if, upon notice of 30 days after being directed by the Federal reserve board to make good its required reserve so as to bring it up to $33\frac{1}{3}$ per cent, any Federal reserve bank fails to comply with directions, the Federal reserve board shall have power to close the bank and appoint a receiver therefor.

SECTION 23.

In section 23 it is sought to improve upon and strengthen existing bank examination requirements, in the belief that the latter are not now sufficiently effective and that existing authorities have not the power to carry through such examinations either with the thoroughness or the frequency that the circumstances demand. Section 23 therefore provides for a change in the method of compensating bank examiners and alters in various details the methods now employed in carrying out the examinations.

In view of the close and intimate relationships which are to be maintained between Federal reserve banks and their member banks, and in view of the fact that the Federal reserve banks are authorized to act as clearing houses for such member banks, the power is bestowed upon the Federal reserve banks subject to the oversight of the Federal reserve board to carry on examinations of member banks as it may deem best. These examinations would be similar to those now conducted by clearing-house associations.

Paragraph 3 of the section authorizes the Federal reserve board to make an examination not less frequently than four times a year of national banks in reserve cities. This is in view of the fact that the reserve cities, if they continue to be such, will have the power of holding bank funds and of conducting all of the functions they now perform. It has been found in the past that the condition of city banks changed much more rapidly than did that of country banks, and it is therefore thought to be desirable that specially close oversight should be maintained with regard to this class of banks.

It has been complained that under this section national banks in reserve cities would be under examination nearly all the time. No charge of the sort can be sustained. The Federal reserve board's examinations of banks in reserve cities, which are to be made four times a year, are not additional to the two examinations of every national banking association described in the first paragraph, but include them. In other words, banks ranked as country banks are to be examined at least twice and all others at least four times a year by the Federal reserve board, while, if desired, the reserve bank of each district may have a system of its own for keeping advised of the affairs of member banks—a plan employed by clearing-house associations to-day. The specifications with reference to the items to be shown in the reports of examination of national banks in reserve cities cover items that have been, it is thought, neglected under past legislation.

In general the purpose of this section is to convey all reasonable and necessary power of bank examination, to place it where it can be most effectively used, and to assume that the power is to be used for the purpose of strengthening, protecting, but certainly not of annoying or crippling the banks to which it is applied.

SECTION 24.

In this section it is sought to correct a bad practice, all too prevalent, of paying fees to bank examiners in order that they may make a favorable report upon the condition of a bank; and further to end the illegitimate practice whereby officers of national banks have heretofore profited at the expense of borrowers by charging a commission or brokerage for the obtaining of loans. The extent of these practices can not be stated, but that they prevail is certain; and it is equally clear that they are opposed to public welfare and to sound banking, besides being wholly at variance with fundamental principles of honorable personal conduct.

SECTION 25.

In this section it is endeavored to overcome the practice which has sprung up on the part of dishonest or cowardly national bank stockholders of evading the double liability provision when they have been informed of the failure of a bank in which they hold shares, by transferring such shares to some "dummy" who is immune from recovery under the double-liability provision. It is believed that by making stockholders who have transferred their shares 60 days before a bank failure equally as liable as if they had not made such transfer, the needs of the situation will be met. Some have alleged that the requirements should be that stockholders be liable whenever and so long as it could be proven that they had knowledge of the impending bank failure, but that they should not be liable if in good faith they transferred their shares within 60 days before a failure. This sounds plausible but is at variance with the facts of experience. The process of proving that a stockholder had knowledge is difficult and expensive, if not impossible in many cases, and it is believed that the 60-day provision is entirely equitable and far more workable.

SECTION 26.

Loans on improved farm lands are provided for in this section under strict limitations as to the value of the security and the amount of the loan as compared with the face of the bank's capital. The loans are limited to a period of twelve months, and are permitted only in the case of country banks. This provision has not been made, as seems to be supposed in some quarters, for the purpose of furnishing a means of supplying farmers with working capital. It has been made upon the advice of practical bankers, in recognition of the fact that in many parts of the country the principal or almost the sole business of national banks is found in making loans to farmers, and that while these loans are in every sense commercial in that they are to be paid back out of the proceeds of a business process then going on—the raising and marketing of a crop—the only actual security the farmer can offer is a lien upon his land and its products. To allow the bank to take this lien enables it to do frankly and truthfully, with due protection to itself, business that it will probably do in some way, even if not thus authorized, inasmuch as the well-being of the community and the transaction of its business calls for the extension of loans to farmers who are engaged in the process of growing and marketing consumable articles and who need working capital in order to facilitate their operations. The total amount of such loans which could be made under the provisions of this section might run as high as $150,000,000, but is not likely to approximate that sum.

SECTION 27.

Permission to national banks to open departments specifically designed for the reception of savings deposits and conducted with a view to the separate investment and protection of such savings deposits is granted in section 27. For a long time national banks have found their business encroached upon by the growth of savings banks and trust companies, and in several hundred instances they are now found evading the law by the organization of allied concerns which are carried on as trust companies or savings banks under technically separate organization, but really under an identical control. The committee, while strongly believing in the principle of a corps of commercial closely restricted banks as the basic element in the country's credit system, believes that with the added strength afforded by the new Federal reserve banks, Congress may reasonably relax some of the restrictions now surrounding the business of national banks and allow to national institutions the savings bank and limited trustee functions recognized in this section without unduly straining the essential structure of the national banking system, provided that savings departments if organized shall be conducted upon an entirely separate basis from the commercial departments of the national banks creating them, with segregated reserves and strictly segregated assets. Some further restrictions have been laid down in the section which are largely self-explanatory.

SECTION 28.

There has long been a demand for an extension of the powers of national banks which would permit them to facilitate foreign trade and do business abroad. The plan upon which the committee has determined after much consideration and comparison of various competing propositions calls for permission to national banks having a capital of $1,000,000 or over to establish branch banks in foreign countries whenever they may deem best, subject to regulations to be prescribed by the Federal reserve board. It is, however, required that due application shall be made to the reserve board for permission to establish such branches and that in establishing them the bank in question shall set aside a specified amount of its capital for use at the said branches and shall submit to suitable examination of the affairs of the branches. A separate accounting system is ordered to be maintained at each branch in order that it may be known exactly how successfully each such independent institution is being carried on, and in order to prevent unsuccessful operations engaged in at one point from being covered up in the affairs of the institution as a whole. Inasmuch as the requirements concerning the creation of these branches are necessarily general in terms, section 28 naturally specifies that a power of further regulation from the administrative standpoint shall be lodged with the Federal reserve board in order that the said board may exercise a suitable control over the doings of the banks which apply for such permission, and of their branches.

SECTION 29.

Section 29 is merely the usual provision for repeal of inconsistent statutory requirements, whatever they may be, that might conflict with the terms of the legislation now proposed for adoption.

SECTION 30.

Section 30 specifies that Congress retains the right to amend, alter, or repeal the act—a power reserved, no doubt, in any event, but which it has been deemed best to express in specific language.