

Federal Reserve System Called Huge Storage Tank for Money

Editor's note: Following is the third of six dispatches explaining the complex economic machinery that controls the nation's supply of money.

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New York — (UPI) — The nation's super bank — the Federal Reserve System — is a gigantic storage tank for money.

Dollars flow into the bank because of a law forcing commercial banks to put a part of your deposits into the super bank for storage. The rest is theirs to lend.

Originally the storage tank was designed to give a bank cash reserves in case a lot of depositors wanted their money back at once and all at the same time. With funds on reserve it could meet this demand without calling loans back for repayment.

But the tank later worked into a handy tool for controlling the amount of funds a bank could lend. Here's how:

If the reserve level in the tank drops for any reason then a bank must scramble to secure funds elsewhere to bring its reserves back to the required level. This puts the squeeze on the bank. It might have to refuse loans — perhaps call back some for repayment.

Special Type of Money
The tool is even more powerful because these reserves are a very special type of money. Each reserve dollar can be ballooned into six actual dollars because of the ability of banks to create the money by making loans.

The super bank has at its disposal certain other machinery enabling it to increase or lessen the storage tank level.

Probably the most important of these involves open market operations — the actions of a committee sitting at Federal Reserve headquarters in Washington.

What they do is buy and

sell government bonds (except savings bonds and certain special issues) to dealers. These dealers are just like the corner grocer who buys a can of tomatoes hoping to make a profit. They buy from and sell to not only the Federal Reserve but also to banks, insurance companies and large corporations.

When the open market committee feels it's necessary to increase reserves, it buys government securities, paying dealers with a Federal Reserve check.

When a dealer's bank sends the check to the Federal Reserve Bank of its district to be collected, the reserve bank in effect creates the money by crediting that bank's account. Since reserves already had to be at the required level, the tank spills over, giving the bank the excess to lend.

Works in Reverse
When securities are sold, the process works in reverse, wiping out that much in reserves.

But banks also may borrow from the super bank for brief periods to keep their storage tank money at the required level. This acts as a safety valve so banks aren't forced into calling loans when they are unexpectedly short in the tank.

A loan of this type is called a discount. The fee or rate the super bank charges on this type of loan is the discount rate.

In the early stages of the system when the Federal Reserve wanted to discourage loans of this sort, it raised the fee and when it wanted to stimulate loans it lowered the fee. Now, however, a change in the rate is a signal to the nation that the Federal Reserve is loosening or tightening its reins on credit.

For example, in Mid-August the system started to raise the discount rate from 1 3/4 to 2 per cent, signalling that

money would be a little tighter than it had been at the bottom of the recession. Before the recession set in, the discount rate had been at 3 1/2 per cent.

Can Change Requirements
Probably the most powerful machinery of the super bank is its ability to change storage tank requirements itself.

Currently these requirements average about 16 per cent of checking deposits. A change of one percentage point in these requirements means a change of about \$1 billion in bank reserves, money which can be blown up or contracted roughly six times.

This machinery is not often used, largely because it is so powerful. When it is used, the Federal Reserve tempers its impact with its other tools.

Some other factors affect reserves but are not controlled directly by the super bank. These are such things as currency and coin in circulation, or gold stocks.

An increase in currency in circulation occurs around holiday periods. After Thanksgiving, for example, people trek to their banks for an additional \$500 million or more in folding money for Christmas shopping. After Christmas the money returns to the bank.

Extra From Reserves
Since banks always have to have a certain amount of cash on hand, they get the extra money to cover the public's withdrawals from their reserves at the Federal Reserve.

The U.S. has gold, more than \$20 billion worth, salted away as backing for the currency. You can't buy gold, but foreign countries can. And when they do it also affects reserves.

The reason is simply that foreign countries have to pay for the gold in dollars drawn out of their accounts in U.S. banks. Their check to the

Grange News...

Sams Valley Grange
To elect officers of the Sams Valley Grange, a meeting was held Saturday, November 22.

Those elected are Albert Straus, master; Elwood Abbott, overseer; Victor Croxton, lecturer; Earnest Radomske, steward; Dennis Duggan, gatekeeper; Michael Dugan, assistant steward; Ralph James, secretary; Mrs. Elwood Abbott, treasurer; and Mrs. Earnest Radomske, chaplain.

Those who will fill the positions of the Graces are Mrs. Dalton Straus, Ceres; Mrs. Albert Straus, Pamona; and Mrs. Jerome Fitzgerald, Flora. The lady assistant steward elect is Miss Alice Croxton, and Jerome Fitzgerald, William Duggan, and Herman Priem combine to form the executive committee. Miss Connie McDonough has been elected Grange musician.

Those comprising the Home Economics committee are Mrs. Victor Croxton, chairman, and Mrs. Ramsey Thompson and Mrs. Herman Priem.

The U. S. has about 1,500,000 hospital beds and estimates show a need for about 800,000 more.

Treasury is sent to the Federal Reserve for collection. The super bank then lowers the storage tank account of the bank on which the check is drawn and credits the treasury's account.
(Next: The Story of a Check)

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