Minutes of actions taken by the Board of Governors of the Federal Reserve System on Wednesday, November 26, 1947. The Board met in the Board Room at 2:35 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Clayton

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Chairman
Mr. Smead, Director of the Division of Bank Operations
Mr. Thomas, Director of the Division of Research and Statistics
Mr. Vest, General Counsel
Mr. Leonard, Director of the Division of Examinations
Mr. Nelson, Director of the Division of Personnel Administration
Mr. Baumann, Assistant Counsel

Mr. Clayton referred to the discussion at the meeting on November 21, 1947, at which he was authorized to take up with the Comptroller of the Currency the question of possible changes in capital requirements of member banks, with respect to which the Legal Division prepared a memorandum under date of October 21, 1947, in which certain questions were presented for the consideration of the Board.

There was a further discussion of the questions that had been considered at the meeting on November 21, during which it was stated that the Board was interested in legislation which would amend the capital requirements for the admission of State banks to membership

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in the System and for the establishment of branches by member banks, because the present requirements result in unfair discrimination against State member and national banks and thus close the door to membership for many State banks which are otherwise eligible and also lead to the withdrawal of State banks from membership and the conversion of national banks into State nonmember banks. It was also stated that capital requirements for admission of State banks were now based largely upon those for organization of national banks, and that, accordingly, any change in the law with respect to requirements for State banks raised the question whether similar changes in the requirements for national banks were desirable.

At the conclusion of the discussion, the staff was requested to prepare for consideration by the Board a draft of letter to the Comptroller of the Currency along the lines suggested during the discussion.

Yesterday Chairman Eccles appeared before the Joint Committee on the Economic Report and, in accordance with a procedure which was informally concurred in by the members of the Board, made substantially the following statement:

"In appearing before you today I wish to make clear that I am speaking for the Board of Governors of the Federal Reserve System, an agency of Congress, and I am not undertaking to speak for the Administration or the Presidents of the 12 Federal Reserve Banks.

"You have requested me to testify, I take it, as to what might be done in the monetary and credit field to deal with inflationary forces, which have already gone so far as

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"to cause very serious maladjustments within the economy. Correction is overdue. The longer it is postponed, the more severe will be the inevitable reaction.

"I am sure this Committee recognizes that a great many factors and forces contributed to the inflationary problem and that there is no easy, simple, or single remedy. We are already in the advanced stages of this disease. It is no longer a question of preventing it, but of moderating so far as possible its ultimate ravages.

"At best, monetary and credit policy can have only a supplemental influence in any effective treatment of either inflation or deflation. In considering what can be done so far as monetary and credit action is concerned, it is necessary to make a correct diagnosis of the multiple causes of the situation with which we are now confronted.

"What is inflation? It is the condition which exists when effective demand exceeds the overall supply of goods and services. Potential overall demand always exceeds supply. What is lacking in deflation is effective demand. We are witnessing effective demand today when individuals and businesses, together with State and local governments, as well as the Federal Government, generally have money which they are trying to spend, bidding for an insufficient supply of goods and services. This effective purchasing power is composed of past savings, current income, or future credit. The savings were largely accumulated during the war years in the form of currency, bank deposits and Government securities.

"At the end of 1946, individuals and businesses held about 223 billion dollars of such liquid savings, or more than three times the prewar total. Similarly, current national income is at an all-time high level. It is running at a rate of 200 billions a year, or about two and a half times the total for 1940, the highest year prior to the war. It is due to a record high agricultural income, high wages of organized labor and other workers, but not all of them, and unprecedented business profits. This is augmented by a readily available supply of excessively easy credit for consumers' goods of all kinds, for housing, for short- and long-term business loans, for State and municipal expenditures, and for foreign credits and grants. The notable exception is loans to buy listed stocks, which are sharply restricted by the Board's margin requirements.

"In the face of these large and expanding demands, production is practically at capacity and further growth will necessarily be slow. The physical volume of output of manufactured goods and minerals in 1947 has averaged 186 per cent

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"of the 1935-39 average. Current output is about one-fifth below the wartime level, largely because of the reduction in weekly working hours. Agricultural output in physical terms has continued for the past three years at record levels of about a third above the maximum of any prewar year. This volume reflects general favorable weather and further growth can hardly be expected. Construction of all kinds, including residential building, is close to any previous peacetime peak. Expansion in building is now being retarded by shortages of essential labor and materials. Railroad transportation is limited by the shortages of railroad cars and other equipment. Employment is at very high levels with acute shortages in many fields and with a minimum of unemployment.

"The source of the present inflation is war financing and the enormous Federal deficits incurred in preparation for and prosecution of global war. During the six-year period, June 30, 1940 through June 30, 1946, the Government raised about 398 billion dollars, but only 176 billion dollars, or 44 per cent came from taxes. The remainder of 222 billions, or about 56 per cent, was raised by borrowing. And of this total which was borrowed, approximately 90 billion dollars, or 23 per cent of total needs, was raised by selling Government securities to the commercial banking system, including those purchased by the Federal Reserve Banks.

"As the Reserve Board stated in its 1945 Annual Report to Congress, it is important to bear in mind that borrowing from the banking system, whether by the Government or by others, creates an equivalent addition to the country's money supply. To the extent that the Government did not finance its war program by taxation, it was obliged to borrow, and to the extent that it did not borrow from nonbank investors, it relied upon the banks and thus created new supplies of money. The Federal Reserve by purchasing Government securities, supplied the commercial banks with reserves needed as a basis for the increased money supply.

"As a result, the country's money supply, as measured by privately held demand deposits and currency in circulation, increased more than two and one-half times, rising from less than 40 billion dollars in June of 1940 to 106 billions at the end of June 1946. In the same period, time or savings deposits nearly doubled. In addition, the general public, outside of banks, insurance companies, and Government agencies, accumulated or increased holdings of Government securities to 100 billion dollars, or nearly seven times as much as in June of 1940. These Government securities in the hands of the public are the equivalent of money because they are readily convertible into cash.

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"It should be strongly emphasized that the banking system was the instrument, and not the instigator, of this swollen money supply. The bankers performed a vital service in the financing of the war and particularly in the sale and distribution of savings bonds and of other Government securities.

"If it were possible to finance a great war entirely by taxation there would, of course, be no increase in the public debt. Or if it were possible to do the financing by a combination of taxation and borrowing outside of the banking system, there would be no increase in the money supply. In retrospect, we can see that we could have and probably should have taxed more and borrowed more from nonbank investors and less from the banking system. We are suffering the consequences today of an excessively swollen money supply which neither the bankers individually nor Government authorities have adequate means at present of controlling.

"In order to enable the banks to purchase Government securities essential to the financing of the war, the Federal Reserve System maintained easy money conditions and made Federal Reserve credit and reserves readily available to the banks. The vast money supply thus created was held in check by an elaborate harness of controls consisting, among other things, of allocations of scarce materials, construction permits, price and wage ceilings, rationing, and the excess profits tax. When the harness of controls was prematurely removed and no effective substitute was devised to hold back the flood of effective demand, it was apparent, or at least it should have been apparent, that a sharp rise in prices was inevitable.

"As a result, the economy was caught in a dangerous wage-price-profit-credit spiral, acutely intensified by short farm crops abroad, and reduced corn and cotton crops at home. Critical conditions abroad, in part resulting from our rising prices, impose upon us obligations which must be met even though they add to our inflationary difficulties.

"It would be blindly and foolishly optimistic to believe that the spiral of inflation can continue through further general wage, price and profit increases and further overall expansion of credit without ultimate serious deflation. The longer the necessary readjustment is delayed, the longer it will take to reach a stable condition of employment and production. The most serious maladjustments are evidenced by the increasing numbers of our people whose incomes do not keep pace with the rising cost of living. They are being priced out of the market for housing and many other things, and in countless instances their savings and credit have already been exhausted. The higher prices rise and credit expands, the greater the subsequent liquidation and downward pressure on

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"prices is bound to be. As the November letter of the National City Bank of New York correctly states, 'Rapidly accumulating debt is both a cause and a consequence of the inflationary pressures, for in a wage-price spiral, business constantly needs more and more money to keep going and this leads to the incurrence of more and more debt by business and more and more spending by the individual. To check this kind of spiralling--which is to the ultimate benefit of no one and to the injury of all--is not simple.'

"The problem we all face now is what can be done at this late stage, if necessary, to curb further inflationary developments. As a practical matter, we cannot now put back the elaborate harness of wartime controls, and it seems that we are left only with the choice of certain curbs or restraints selectively applied at some of the more critical points of danger.

"In the absence of a comprehensive scheme of controls we must continue to put our main reliance on fiscal policy, which is by far the most effective way to deal with the demand side of the equation, while we do everything possible to maintain and increase production. We should have the largest possible budgetary surplus while the inflation danger exists. And this means taking from the public in taxes money that otherwise would continue in the spending stream. It means rigid Government economy. It means deferment of all expenditures, Federal, State, or local, to the greatest extent consistent with public obligations at home and abroad. Using the budgetary surplus to pay off bank-held public debt as it becomes due will reduce the money supply by an equivalent amount. This is a reversal of the process by which the money supply was expanded. In an inflationary boom such as we are experiencing the Government should pay off as much of its debt as possible.

"Public debt cannot be reduced during deflation. Budgetary deficits, not surpluses, are an inevitable consequence of serious deflation. Tax reduction would be appropriate after deflation sets in, not during an inflationary period. If a reduction of taxes at this time would, in fact, call forth more production, then it would be justified. Today we still have acute scarcities of labor and materials. Adding to existing buying power either by tax reduction or aggregate expansion of credit can only have the effect of bidding up the prices paid for both labor and materials. If conditions were reversed and we had idle labor and a surplus of materials and productive facilities coupled with a shortage of capital and insufficient purchasing power, then reductions in taxes, particularly those which would stimulate mass buying power, would be in order.

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"If I were to outline a program to meet the situation with which we are now faced, I would list the following steps to deal with the causes rather than with the effects of inflationary pressures. They are listed in what I consider their order of importance.

"1. Increased productivity both at home and abroad. Production is the ultimate solution for inflation. Nothing could be more effective than increased productivity of labor and longer hours of work by everyone. In short, if all who are engaged in producing goods and essential services were to work more, and save more, and spend less, the unbalanced relationship between demand and supply would most effectively be corrected and prices would come down.

"2. Suspension of future demands for wage increases, especially those of organized labor where the increases have been greatest, is necessary if the present unbalanced relationship is to be corrected without severe deflation. Business profits after taxes are more than double what they were in any prewar year and almost double the profits in any war year, and therefore business should hold prices down or should reduce them, in accordance with what would be reasonable earnings.

"3. A fiscal policy to produce the largest possible surplus to be used to pay off bank-held Government debt and thus reduce the money supply. This means the greatest possible economy in all Government expenditures. It means more adequate financial support of the tax collection machinery of the Government to prevent tax evasion. It means no general decrease in tax rates at this time. It should also mean the elimination of the agricultural price support program unless price ceilings are reimposed.

"4. Legislation giving the Federal Reserve System such authority as may be necessary to restrict further overall expansion of bank credit. The need for this authority would be less if Congress authorized other anti-inflationary measures such as restoration of consumer instalment credit restrictions and if stricter appraisals and less liberal credit terms were applied under the Veterans' Administration, the FHA, and the Home Loan Bank programs of housing finance.

"5. Continuation and expansion of the Treasury's Savings Bond campaign, with adequate financial support by Congress. Funds so raised have a two-fold effect. It removes these funds from the spending stream and makes them available to pay off bank-held debt, thus reducing the money supply.

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"Other actions have been proposed which, however, deal with the effects rather than the causes. Allocations, construction permits, price and wage ceilings, commodity margin requirements, instalment credit regulation, export and rent controls, and similar devices are all in the category of curbs rather than cures. Where they can be applied as a practical matter and enforced, they can be useful, but they do not go to the sources of the problem.

"I should like to summarize what the Federal Reserve Board believes might be done in the monetary and credit field. In its 1945 and 1946 Annual Reports to Congress the Federal Reserve Board described the situation in which those with responsibility for monetary policy find themselves as a consequence of the war. As the Board stated in the 1945 report:

> 'In common with other nations whose energies were devoted primarily to winning the victory, the United States had no choice, under the exigencies of a global war, except to use monetary powers in furtherance of essential war financing and not as an anti-inflationary weapon. There has been a widespread assumption that, with the coming of peace, such statutory powers as the Reserve System possesses should be exerted in the traditional way against the heavy inflationary forces at present confronting the country. The Board believes that such an assumption does not take sufficiently into account either the inherent limitations of the System's existing statutory powers, under present-day conditions, or the inevitable repercussions on the economy generally and on the Government's financing operations in particular of an exercise of such existing powers to the degree necessary to be an effective anti-inflationary influence.'

"Of late the Federal Reserve System has been increasingly criticized for not adequately using its existing statutory powers to restrain bank credit expansion. It is very important, therefore, that the Congress understand what those powers are and why the Board does not believe they can be used to deal with the credit problem, and why we suggested in the 1945 and 1946 reports, and suggest now, that Congress consider providing other authority that may be necessary to cope with the situation. We did not then and we do not now seek power, but we feel that we would be remiss, as an agency of Congress, if we failed to report the situation as we see it and to propose alternative means of dealing with it inasmuch as we feel that our existing powers are insufficient.

"The Reserve System has always had broad powers to influence the supply and cost of bank credit. Through open market

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"operations, that is, buying and selling of Government securities, the System either gives reserves to the banks or absorbs reserves. Reserves are the foundation on which bank credit is built. If banks have no reserves they cannot lend. But they can obtain reserves when they borrow from the Federal Reserve Banks or sell Government securities to the Reserve Banks. And the banking system automatically receives reserves through gold acquisitions, and also when the Federal Reserve Banks buy Government securities from nonbank investors. The Reserve System can restrain banks from borrowing by raising the discount rate sufficiently high to make the borrowing unprofitable. It could refuse to buy Government securities and shut off that source of reserves. It has no powers to deal with reserves arising from gold acquisitions.

"Why, then, doesn't the System simply make the discount rate prohibitive and at the same time refuse to buy any more Government securities? Let me say that if the Congress disagrees with us and feels, as do some bankers and insurance company executives, that we should more fully use existing powers, we would welcome such an expression from the Congress. In that case, there would be no need to consider any alternative powers. On the other hand, if Congress agrees that our existing powers are not appropriate under present circumstances, full consideration should be given to any proposal that would help to meet the situation.

"First, let us consider what the effect would be of raising the discount rate by itself. Actually, the effect would be negligible, except for possible psychological reaction, because as long as the System stands ready to buy Government securities in the open market, banks can obtain reserves at will by selling such securities out of their portfolios. Suppose, then, that the System refused to buy the securities--and that is the heart of the matter--what would the consequences be? Bear in mind that the total interest-bearing debt of the Government is 256 billion dollars, more than five times what it was before the war. The public debt at the beginning of 1940 was about one-fifth of the total public and private debt of the country, whereas at the present time it is nearly two-thirds of the entire indebtedness of the country. About one-third of the total Government debt is short-term marketable debt and would need to be refunded into higher-rate securities. This would raise the cost to the Government, and therefore to the taxpayers, of carrying the public debt. Already the nation's tax bill for interest cost is approximately 5 billion dollars or nearly one-seventh of the total Federal budget.

"Just how high would interest rates have to rise to deter business and individuals from borrowing from banks? Higher

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"interest rates do not deter the lender. Rising interest rates are like rising prices. At some point they do deter the borrower or the buyer. They do not deter the lender or the seller. I doubt if anybody knows how high interest rates, especially short-term rates, would have to rise to discourage borrowers. Certainly the rates would have to be substantially above the present relatively low levels. Bank customers, particularly business, with seemingly insatiable markets awaiting their products, are hardly to be deterred by one or two points of increase in bank interest rates.

"The additional costs to the Government in carrying the public debt would be difficult to estimate, but they would amount to billions a year over a period of time. If that were the only consequence, it might be argued that the extra cost to the Government would be justified because inflationary borrowings would cease.

"However, this is only one aspect of the matter. In the process of leaving Government securities to the free play of variable forces in the market, the Treasury would be confronted with a continuing puzzle in all of its constantly recurrent refunding operations. It could not tell from day to day at what price it could sell its securities. It would be entirely at the mercy of uncontrolled factors in the market, if, indeed, conditions did not become so confused and chaotic as to demoralize completely any refunding operations.

"I recently saw a prediction by a very keen bond market analyst that failure of the Reserve System to support the 2-1/2 per cent rate on marketable Government bonds would lead to a wholesale liquidation of all Government bonds, including the nonmarketable E, F and G bonds. He declared that it would be the most dramatically inflationary move that could be made at this time, the repercussions of which would be, as he put it, so catastrophic as to make present fears appear as one raindrop in a storm. That is strong language. Nobody can say with certainty that it is too exaggerated.

"In any case, I think it is fairly clear that withdrawing support from the Government securities market and letting interest rates rise on Government securities would not increase the power of the Federal Reserve System to offset increases in bank reserves from gold acquisitions. Sales of System holdings of Government securities for this purpose would have to compete with private credit demands. Private borrowers might outbid us for these reserves. There would be no certain level of security prices or interest rates at which we could dispose of enough Government securities to offset gold imports.

"On the other hand, we have to recognize what would happen if we follow the present course of policy in order to maintain the public's confidence in Government credit and avoid any unnecessary increase in the interest cost to the Government for

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"carrying the public debt. Commercial banks currently hold about 70 billion dollars of Government securities. This sum is about 50 per cent of their total deposits. If they should sell half of these securities and the Federal Reserve System, in providing an ultimate market, should buy them, the banks would acquire an equivalent volume of new reserves. On the basis of these reserves, the banks could expand credit by about six times, or by more than 200 billion dollars. This is nearly double the present amount of demand deposits and currency. While it is unlikely that the banks would dispose of so large a proportion of their holdings, it nevertheless is a measure of the potential bank credit expansion that can occur if the banks are left with complete freedom to convert their Government security holdings into reserves at will.

"This bank credit expansion potential is apart from other sources of bank reserves. Gold is now flowing into our banking system in large quantities from foreign holdings. As a result, deposits are increased and on the asset side banks gain an equal amount of reserves. Over the next year, the gold inflow is estimated at from 2 to 3 billion dollars. Multiplied by six, this would permit an expansion of bank credit of from 12 to 18 billions.

"There are two other important potential sources of increased bank reserves. Nonbank investors, mainly business corporations, hold about 13 billion dollars of short-term Government securities. Businesses face increasing needs for working capital under prevailing inflationary conditions. To some extent, these needs will be met by sales of short-term Government securities, which the Reserve System may have to buy.

"The second possible source of bank reserves is the 59 billions of marketable, medium- and long-term Government securities held by nonbank investors. With widening opportunities for the placement of funds in private investment at increasingly attractive yields, there is a small amount of shifting by investors of their holdings of marketable long-term Government securities. If inflation continues, this shifting will likely increase. Such sales have to be met by Federal Reserve support of the prices of marketable Government bonds so as to protect the 2-1/2 per cent rate on long-term issues. The result of these support operations is to increase bank reserves and thus to support further inflation.

"Under present and prospective conditions, it is not only desirable but essential, in the opinion of the Treasury and of the Reserve System, that the established 2-1/2 per cent rate on long-term marketable Government securities be maintained.

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"The Federal Reserve Board has one other power that it has been criticized by some for not using. That is the power to raise the reserve requirements of the banks in New York and Chicago from 20 to 26 per cent of their net demand deposits. This is a relatively minor matter and does not in any way go to the heart of the problem. Any action taken would have an effect on banking conditions only in two cities in which the credit expansion, as well as deposit growth, has been relatively less than for the rest of the country.

"We have given a great deal of study to this admittedly difficult and complex problem. We are convinced that the remedy of letting interest rates on Government debt go up on the theory that this would bring an end to inflationary borrowing is dubious at best, as has been demonstrated in past monetary history, notably in the 20's when high rates were unsuccessful in restraining speculation in the stock markets, real estate, or otherwise.

"As was made clear in the Annual Report for 1946, we are not opposed in principle to higher interest rates if some desirable ends and the public interest can be served by such a policy. In fact, in recent months we have cooperated with the Treasury in permitting some moderate, corrective rise from wartime levels of interest rates on short-term Government securities. This adjustment was made to reduce the wide differential prevailing between short-term and long-term interest rates. Such a large differential was having the effect of encouraging banks to sell short-term securities, which the Federal Reserve bought, and to buy long-term securities in the process, thereby encouraging multiple credit expansion. The differential in rates was also exerting a strong downward pressure on yields of long-term securities. We were aware that this decline was artificially induced by investment policies of the banking system known as monetization of the public debt, and resulted in bank credit expansion. We also recognized the importance of checking the decline in long-term interest rates to protect educational, charitable, and pension funds, as well as insurance institutions, savings banks, and individuals depending upon interest for income.

"The action permitting a moderate rise in short-term interest rates coincided, however, with strong demands for long-term funds, which put considerable strain on the market for corporate and municipal securities. As a consequence, these issues have been made more attractive as investments. They are thus somewhat more competitive with long-term Governments than before. We have to face this fact of the market

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"place and be prepared to offset any shifts in investor holdings from Government bonds to other securities. The undesirable aspect of the situation, from the standpoint of inflationary credit conditions, is that support of Government bonds adds to bank reserves. These developments indicate that a policy of permitting interest rates on short-term Government securities to rise has gone about as far as can be justified under present circumstances.

"We have, therefore, been compelled to seek some better alternative than higher interest rates to restrain further bank credit expansion. We believe that one is available which will not make the Government and the taxpayer bear the added cost of the restraint, that will impose very little, if any, hardship on the banks, that will, in fact, have a compensating aspect in that the restraint imposed would increase interest rates on private borrowings without additional cost to the Government.

"I refer to the second alternative proposed in the 1945 Annual Report. We recommend for consideration, as the best alternative we have been able to devise, that all commercial banks be required as a temporary measure to hold some percentage of their demand and time deposits, in addition to present reserves, in a special reserve in the form of Treasury bills, certificates and notes or cash, cash items, interbank balances, or balances with Federal Reserve Banks.

"Such a requirement would be far less onerous for the banking system than any other effective method that has been suggested in the long period in which this problem has been discussed by bankers, by economists, and public officials. Manifestly, such a requirement would have to be imposed gradually, if at all, as an offset, for example, to bank reserves created by gold acquisitions and by the purchase of Government securities from nonbank investors, and also to limit the too ready availability of reserves, now enabling banks to obtain them at will. A multiple expansion of credit can be built on these reserves at a ratio of fully six dollars of lending for every dollar of reserves. We would propose that the special reserve requirement be limited by law to a maximum of 25 per cent on demand and 10 per cent on time deposits. It should be made applicable to all commercial banks. It would not be effective if applied only to member banks of the Federal Reserve System, and would be an unjustifiable discrimination.

"We recognize that this proposal is no panacea, but it would be an important, available restraint, now lacking, to be applied equally to all commercial banks so that the individual banker would be in the same competitive situation he is in today. Over the next four months there is likely to be little need for the suggested special reserve because of the large amount of

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"Treasury surplus funds, taken from the market through taxes, which will be available to retire bank-held public debt. This would temporarily exert pressure against bank credit expansion.

"The proposed special reserve requirement has a number of important advantages over other methods of dealing with the problem of restricting the banks' expansion of credit:

"1. The plan would have about the same effect in limiting credit expansion as an increase in primary reserve requirements, which was proposed as the third alternative in the 1945 Annual Report. It would enable the banks to retain the same volume of earning assets that they now hold, whereas an increase in basic reserve requirements would make it necessary for them to reduce earning assets, with adverse effects upon the earnings position of banks.

"2. The ratio of potential credit expansion on a given increase in reserves would be narrowed to the extent that the special reserve was required. At the maximum requirement proposed, it would be lowered from six to one to nearly two and one-half to one.

"3. It would bring about an increase in interest rates on private debt and would increase earnings of the banks from this source where rates on loans are comparatively low. It would accomplish this purpose, moreover, without increasing the interest cost on the public debt or permitting unstable prices in the Government securities market. The plan, in effect, would divorce the market for private debt from the market for Government securities.

"4. The plan would not rely on higher interest rates to restrain private borrowing, but to the extent higher interest rates restrain such borrowing, the proposal would make use of the interest rate mechanism. Hence, the cost of restraining credit would be borne by private borrowers who are incurring additional debt, and not by the Government which is reducing its debt.

"5. The main effect of the plan would be to reduce the availability of bank credit. This would be accomplished by putting the restraint on the lenders, that is, the banks. They would be less willing to sell Government securities in order to expand credit because the amount of such liquid assets as they held as secondary reserves could be greatly reduced by the requirement. Such an authority, even without action being taken by the Reserve authorities, would have a very restraining influence.

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"6. The plan would restore use of the customary instruments of Reserve influence on bank credit expansion, namely, discount rates and open market operations. Support of these instruments by the special reserve requirement would enable the Federal Reserve to make it more difficult and costly for banks to borrow Federal Reserve funds.

"7. No alterations in the banking structure, in the authority of the supervisors, in customary methods of bank operations, or in established interbank relationships would be introduced as a result of imposing the requirement.

"8. The banks would be left by the plan with sufficient latitude to meet essential needs of the economy for credit, and the public would be assured of a high degree of liquidity and safety for the banking system.

"Many bankers argue that this proposed requirement is unnecessary because the banks themselves have a vital interest in the conservative extension of credit, and will prevent excessive credit expansion as a matter of ordinary banking prudence. The banks, however, are confronted by a situation in which they can readily meet unlimited private credit demands and in which such demands are vigorously sustained by inflation while, at the same time, these demands are contributing to inflation. They are both a cause and effect. The banks are not in a position to refuse legitimate, sound credit demands of individual customers, and current loans, taken separately, which in the light of the customer's satisfactory credit risk, do appear to represent legitimate credit needs. But in accommodating these credit demands freely, the banks as a system are expanding bank deposits and adding to the money supply.

"From the beginning of 1946 through October of this year, the banking system as a whole has increased its loans and investments--other than Treasury obligations--by an estimated 12 billion dollars. This has added a like amount to the money supply, which, together with gold acquisitions, is largely responsible for an increase in privately held deposits of 14 billion dollars.

"Reconversion of the economy from war to peace required aggressive bank financing of agriculture, commerce, and industry in order to facilitate the earliest possible attainment of peacetime activity on a much higher level than prevailed before the war. Some of this bank credit expansion for private purposes, therefore, was justified. High levels of peacetime activity have long since been attained, however; yet, bank credit expansion is continuing and in recent months has gained rapid momentum.

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"None of us likes restraints. I am sympathetic with the bankers who resent seeming to be singled out for a special restraint on their wares, which are loans and investments. To the uninformed, it might appear that the banking system has been or is now to blame for the oversupply of money. This is not the case.

"Instinctively and naturally, bankers do not relish restrictions on their activities any more than labor likes wage controls, or agriculture likes price ceilings. We realize that the special reserve proposal which we consider the best alternative, after considering all of the circumstances, will be very strongly resisted by those bankers who fear that it points accusingly at them, or that it is more regimentation, more bureaucratic reaching for power, or an encroachment on State rights, or an opening wedge to force nonmember banks into the Reserve System. All these things have been said to us privately or publicly--and we can only say that if a better alternative can be devised, we would welcome it.

"The Board recommends that the administration of the special reserve plan be placed in the Federal Open Market Committee, whose members, in addition to the Reserve Board, are five presidents of the Federal Reserve Banks. This should help to remove some of the misgivings of bankers.

"The opposition of some very prominent bankers to any new power for the Federal Reserve is expressed in a statement which they have asked me to submit for the record. It is a statement of the Federal Advisory Council, composed of twelve bankers, one from each Federal Reserve district. Often we agree. In this case they unitedly oppose the remedy we advocate. They contend that banks are not indulging in inflationary expansion of credit; that, therefore, the problem should be attacked on other fronts, and that no legislation is required on the banking front. They differ with us also in unanimously opposing reinstatement of instalment credit regulation.

"I am sure the Council's views reflect the opinion of a great many bankers, who are entirely sincere in the belief that the loans they are extending are safe, deserving risks necessary to sustain full production. That conviction, honestly held, is unhappily characteristic of boom psychology. In 1920, or in the latter part of that decade, bankers would have made the same replies that they give today if asked whether they thought the loans they were making should not be made. A short time later they were trying desperately to liquidate some of these loans. The individual banker is judging by standards applying to the individual borrower and risk.

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"The Reserve Board, the Congress, and all responsible for public policy must necessarily approach the whole problem from a different standpoint. The question we must ask is whether any further expansion in the aggregate amount of credit is desirable or dangerous. If it, in fact, calls forth more production it will be desirable. If it only permits one borrower to bid against another would-be buyer for scarce goods and thus adds to upward pressures on prices, it is dangerous. It is our best judgment that overall expansion of the money supply at this time is inflationary and dangerous.

"It is unfortunate, I think, that banking leaders oppose protective measures against inflationary forces arising in the credit field. They seem to forget that in order to assist in war financing, the Government provided the banking system with additional reserves which enabled the banks to buy Government securities; that this created new deposits in the banks; and that banks have also had the benefit of interest received on the Government securities they have held and will continue to hold for an indefinite period. They object even to a temporary limitation on the further use of these funds as a basis for loans to private borrowers, which would in turn create more and more deposits. The Government has an obligation and a duty to step in at this time of national danger to say to the banks, 'We are not proposing to deprive you of benefits you have already derived and will continue to derive from the vast increase in bank deposits resulting from your purchases of Government securities, but we do say that you should be willing to accept a reasonable limitation on using a war-created situation to multiply private loans in peacetime when they serve to intensify inflationary pressures.'

"To sum up, the proposed special reserve requirement is only a part, though a necessary part, of any effective anti-inflationary program. As I have indicated, action on other fronts, by far the most important of which is fiscal policy, is necessary to the success of that program. And the need for action on the monetary and credit front would be reduced to the extent that needed action is taken on other fronts."

Upon motion by Mr. Szymczak, the statement was approved unanimously, with the understanding that a copy would be sent by the Board to all banks in the United States and to the supervisors of banks in each of the 48 states with a transmittal letter reading as follows:

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"The Board of Governors of the Federal Reserve System encloses for your information a copy of my statement before the Joint Committee of the Congress on the Economic Report dealing with the current problem of inflationary bank credit expansion. The Board is sending this statement to you directly because of the importance of the subject matter to the banking community as well as to the public generally."

There was then submitted a draft of reply by the Board to the statement submitted by the Federal Advisory Council on November 17 in response to the Board's inquiry with respect to the expansion of bank credit. The Council's statement and the substance of the Board's reply were presented by Chairman Eccles when he appeared before the Joint Committee on the Economic Report yesterday morning. The draft of reply read as follows:

"The Federal Advisory Council, composed of one banker from each of the twelve Federal Reserve Districts designated under statutory authority to advise the Board of Governors of the Federal Reserve System, was recently asked by the Board for an expression of the Council's views as to the present credit situation. The Board stated that it 'is very much concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means.'

"The Council's reply, which has been released for publication by the Board and presented to Congress by the Chairman of the Board, states that the Council finds 'nothing in bank loans themselves to suggest that growth of loans has been an active inflationary factor. It rather appears to have been a reflection of the very high level of business activity and high prices.' While the Council shares the apprehension of the Board with respect to inflation dangers, it believes that 'the causes of inflation are largely outside the sphere of monetary policy'. Nevertheless it recognizes that 'the Reserve System has a special responsibility for bank credit and in this situation should take all reasonable care to assure conservative credit policies.' The Council expresses the view that in this special area present powers are ample, without new legislation, to place all restraints on credit expansion which the System and the Treasury may consider necessary.

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"Recent credit expansion

"The rapid expansion of bank credit, about which the Board is concerned, is indicated by the growth of bank deposits held by businesses and individuals at all commercial banks in the United States, which increased by 14 billion dollars from the end of 1945 to the end of October this year. The growth exceeded 3 billion dollars in the last four months and is continuing. This growth was on top of a nearly threefold wartime expansion in deposits and currency which was greatly in excess of needs and has been an important basis of postwar inflationary pressures.

"The basis of this continued expansion in bank deposits has been primarily the growth in bank loans, which has been at a more rapid rate than at any time in American banking history, amounting in the aggregate to 10 billion dollars since the end of 1945. Other factors in the deposit increase have been an addition of nearly 2 billion dollars to bank holdings of securities other than those of the Federal Government and gold acquisitions amounting to about 3 billions.

"These increased loans have been made to businesses, to holders of real estate, and to consumers. Only loans on securities have declined. This decrease is due to liquidation of loans made to purchase Government securities in war loan drives, but loans on other securities have also failed to advance. This is an exceptional situation for a period of inflationary development and is in large part due to the Board's regulation of margin requirements.

"It is true, as the Council points out, that banks have reduced their holdings of Government obligations as loans have increased. This decline, however, followed a temporary peak reached during the Victory Loan Drive and resulted almost wholly from Treasury use of its excessive balances at banks temporarily built up to a high level during the drive. It has not had any effect in reducing private deposits.

"Inflationary impact of bank loan expansion

"The Board agrees with the Federal Advisory Council that the basic causes of inflation lie primarily outside of the area of current monetary and banking developments. However, the Board believes that all possible measures and policies should be adopted by Government, business, farmers, and workers to produce more, consume less, and save more, and to avoid cost- and price-raising actions. Furthermore, the Board considers that the most effective means of diminishing the basic causes of inflation is maintenance of the largest possible surplus in the Government's budget. This important means of dealing with the problem is entirely ignored by the Council.

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"The Board also recognizes that individual banks in making loans are no doubt being guided by the aim of meeting the necessary and constructive needs of borrowers, and that many banks are aware of the dangers in the present situation and are exercising some restraint on borrowers. Expansion in lending has to a large extent been necessary to supply working capital needed by business to maintain or increase production at rising prices. As accumulated cash balances are drawn down funds must be borrowed. Consumers also borrow to supplement incomes and purchasers of homes borrow more than sellers repay because of advancing real estate prices.

"In the Board's opinion it is not correct to contend that because inflation calls forth an increased demand for bank loans, these loans do not contribute to inflation. The economy now is caught in a partly self-generating spiral of rising wages, costs, prices, and profits supported by active use of previously accumulated liquid assets and by expanding bank loans. Credit is contributing to the continuation of inflationary pressures. As was well stated, in a recent Monthly Letter of the National City Bank of New York:

> 'Rapidly accumulating debt is both a cause and a consequence of the inflationary pressures, for in a wage-price spiral, business constantly needs more and more money to keep going and this leads to the incurrence of more and more debt by business and more and more spending by the individual. To check this kind of spiralling--which is to the ultimate benefit of no one and to the injury of all--is not simple.'

"Although each loan, taken separately, may aid in the production and movement of goods, yet in view of the limited supplies of goods available, a loan to one business or individual to finance the purchase or holding of goods permits the borrower to bid against someone else who has or is able to obtain funds. Credit expansion thus is called for by price increases and provides the basis for further increases. This process, unless checked by positive limitations on the available supply of credit, could easily lead to catastrophic collapse.

"Bankers, businessmen, farmers, wage earners, who in their operations unwittingly contribute to the rising spiral of inflation, cannot individually be held responsible for its course. That course is the result of reliance on the free-enterprise, competitive price system in a situation where demand, supply, and price are not in equilibrium and where a rise in prices can be prevented only through the maintenance of a harness of controls by Government.

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"For these conditions, the bankers are not responsible either individually or as a group. Their job is to meet the credit needs of their communities constructively, competitively, and profitably; they are not individually in a position to refuse the legitimate, sound credit demands of their customers. They find themselves in a situation in which they can readily meet unlimited credit demands from the public and in which the public's credit demands are vigorously sustained. That situation was created by war, by the necessities of war finance, and by premature abandonment of controls, thereby releasing inflationary pressures. Responsibility of the individual banker for developments can go no further than observance of prudent policy in the extension of credit and the maintenance of proper soundness of loans and liquidity and safety of individual banks.

"Responsibility of Government for credit expansion

"The Federal Advisory Council states that Government agencies have been making loans that banks refrained from making. Except in the field of foreign lending, the volume of loans by Government credit agencies is very small relative to the volume of bank loans and the total has not increased. It is true that some of the activities of Government agencies, furthering objectives set forth by Congress, have encouraged unhealthy credit expansion in the field of housing, primarily to aid veterans. Foreign lending by the Government has expanded because of the urgency of restoring production abroad and the difficulties and inadvisability of obtaining private credits for these essential purposes.

"The Council refers to the Board's request for authority to guarantee loans in cases where credit is needed but cannot be obtained from banks. The Board wishes it clearly understood that it is requesting merely an amendment of an existing provision of law, for the purpose of rescinding a power which the Reserve Banks already have to make loans and revising somewhat their power to guarantee loans. Under existing conditions these powers are not likely to be used but some such power will be needed at times in the future to provide for small business a source of capital, which large corporations can obtain through sales of securities in the market. Amendment of existing law has been recommended to enable the System to return certain funds to the Treasury and this provides an appropriate opportunity to make other long-needed revisions. With reference to this bill the Federal Advisory Council expressed its views on November 18, 1947, as follows:

'The Council is cognizant of the investigation of the activities and powers of the Reconstruction Finance Corporation now being made by a Congressional Committee. Until Congress has determined whether the Reconstruction

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"'Finance Corporation should be continued, and, if continued, what powers to make or guarantee loans should be given it, the Council feels that no action by Congress should be taken on Senate Bill 408. The Council feels that Senate Bill 408 should be considered only as an alternative to legislation continuing the present loan and guarantee powers of the Reconstruction Finance Corporation. If the Congress should decide to continue the Reconstruction Finance Corporation without greatly curtailing its loan and guaranteeing powers, the Council would be opposed to the passage of Senate Bill 408. The majority of the Council would prefer Senate Bill 408 to the continuation of the Reconstruction Finance Corporation powers, but it should also be noted that a minority of the Council is against giving any guarantee or commitment powers to the Federal Reserve Banks under any circumstances, as proposed in Senate Bill 408.'

"Means of restricting inflation

"The Board cannot agree with the Council's view that the Reserve System and the Treasury have ample powers to place all restraints on credit expansion that the System may consider necessary. As the Board has pointed out in its Annual Reports for 1945 and 1946 and in other statements, banks are in a position to provide any additional credit demanded by borrowers and the System cannot prevent such expansion. This is the case because commercial banks of the country now hold 70 billion dollars of United States Government securities, any part of which they can readily sell in order to obtain funds to make loans.

"When banks sell Government securities, the Federal Reserve, which provides the ultimate market for Government securities, must purchase them in the absence of other buyers in order to prevent a breakdown of the securities market. Federal Reserve purchases create bank reserves which can be expanded by the banking system into more than six times as much in loans and investments.

"The Council suggests that the System can restrain inflationary credit expansion through use of existing powers, including authority to increase the discount rate, to sell securities in the open market, and to raise reserve requirements at central reserve city banks. None of these powers can be used effectively if banks continue to sell Government securities to the Reserve System and thus create additional bank reserves.

"In fact attempt to use these powers would increase sales of Government securities in the market by banks and others. If the System refused to purchase any more securities, bond prices would decline sharply. The threat of such a policy would induce

"a wave of selling of marketable bonds, and if prices on these bonds declined there might be widespread redemption of savings bonds, which are redeemable on demand. The Reserve System would have to purchase securities in order to meet the drains on the Treasury, and new reserves would thereby be created.

"Recent measures by the System and the Treasury to raise interest rates on short-term Government securities have diminished somewhat the inducement to banks to sell short-term securities and to purchase longer-term higher-rate issues. Higher rates on short-term securities, however, have but little, if any, influence in discouraging banks from selling them to make loans. Moreover, a recent increase in capital demands has put some pressures on the long-term securities market, and has resulted in a decline in bond prices. This places a limit on the extent to which short-term rates may be permitted to rise without causing an undue drop in Government bond prices.

"The Board has proposed a means of curbing the ability of banks to create additional reserves by selling Government securities to the System and of reducing the amount of credit expansion that may be possible on the basis of reserves thus created or arising from a continued gold inflow. This proposal calls for granting to the System a temporary authority to require all banks to hold a special reserve in Treasury bills, certificates and notes or in certain cash assets, in addition to present basic required reserves.

"This measure would enable the System to impose some restriction on undue credit expansion without depriving banks of earning assets. It would permit a rise in lending rates to new private borrowers without raising the interest cost on the outstanding debt of the Government, which is not now increasing. It would not <u>prevent</u> banks from meeting essential credit needs of the economy but would discourage unrestrained expansion of credit for any purpose.

"Use of an instrument such as the one proposed would enable the System to curb credit expansion with much less burden on banks and less threat to Government credit than would result from attempt to use effectively any of the existing powers mentioned by the Federal Advisory Council."

Upon motion by Mr. Szymczak, the draft of reply was approved unanimously, with the understanding that a copy would be sent promptly to the Joint Committee on the Economic Report, the Presidents of the Federal Reserve Banks, and members of the Federal Advisory Council.

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Chairman Eccles stated that Chairman Tobey of the Senate Banking and Currency Committee had advised that he would like to have a draft of a bill if any had been prepared by the Board in connection with the special reserve plan, that the legal division had been working on such a bill, and that he (Chairman Eccles) would recommend that the Board approve sending the bill to the Chairmen of the Banking and Currency Committees of the Senate and the House of Representatives. The reason for Chairman Tobey's request, Chairman Eccles said, was that he wanted to have a print of a bill when the matter was taken up by his Committee. The draft of bill was in the following form:

"A BILL

"To provide for special reserves to be held by banks, and for other purposes.

"Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Federal Reserve Act is hereby amended by inserting therein immediately following section 19 thereof a new section reading as follows:

'Sec. 19A. (a) Effective Date and Time Limit. - This section shall become effective on the first day of the third calendar month following the month in which it is enacted (except that percentages and other regulations hereunder may be prescribed in advance of the effective date to take effect on or after such date) and shall expire at the end of three years after its effective date.

'(b) Purposes. - As a result of necessary war financing, the banks of the country own large amounts of short-term Government securities. Substantial amounts of such securities have already been converted into bank reserves and large additional amounts can be converted into such reserves with resulting multiple increases in bank credit and in deposits that serve as money. Such monetary and credit expansion, at a time

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"'when total effective demand for goods and services is in excess of the supply which can be produced by the nation's productive capacity and labor force, would further aggravate inflationary pressures on prices and thus produce burdens upon and dislocations in interstate and foreign commerce and the nation's monetary, banking and credit structure. Efforts to avoid such consequences through the use of methods of credit control available under existing law are seriously handicapped because, with the present large volume of the public debt, they would tend to produce such declines in the prices of Government securities (and securities in general) as to cause disturbances to the Government credit, interstate and foreign commerce, and the nation's monetary, banking and credit structure.

'The purposes of this section, in the light of which its provisions shall be construed and applied, are to require banks to hold short-term Government securities or other specified liquid assets in such amounts as may be necessary to protect interstate and foreign commerce and the nation's monetary, banking and credit structure from the above-mentioned burdens, disturbances and dislocations.

'(c) Holding of "Special Reserve Assets". - (1) Every bank shall own "special reserve assets", as described in subsection (d) hereof, in an amount equal to the sum of such percentage of its demand deposits and such percentage of its time deposits as the Federal Open Market Committee (created by section 12A of this Act and hereinafter called the "Committee") may by regulation prescribe from time to time as necessary to accomplish the purposes of this section, but in no event shall the percentage so prescribed with respect to demand deposits exceed 25 per centum or the percentage so prescribed with respect to time deposits exceed 10 per centum.

'(2) The Committee shall not initially prescribe a percentage in excess of 10 per centum with respect to demand deposits or in excess of 4 per centum with respect to time deposits and shall not thereafter at any one time increase such percentages by more than 5 percentage points in the case of demand deposits or by more than 2 percentage points in the case of time deposits. No initial percentage or subsequent increase thereof shall become effective until the expiration of a period of at least 60 days after notice thereof shall have been published in the Federal Register; but no other notice or procedure shall be required in connection with the prescribing of any percentage under this subsection notwithstanding any other provision of law.

'(3) In prescribing any percentages under this subsection, the Committee shall consider among other factors

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"'(A) the volume and ownership of securities and other assets eligible for holding as special reserve assets or readily convertible into such special reserve assets, (B) gold movements, currency fluctuations, and other factors affecting the available supply of bank reserves, (C) conditions in the Government securities market, and (D) the general credit situation of the country.

'(d) Description of "Special Reserve Assets". - "Special reserve assets" shall consist of any one or more of the following assets:

'(1) Obligations of the United States in the form of Treasury bills, certificates of indebtedness, and notes having a maturity not exceeding two years at the time of issue.

'(2) The aggregate amount of the following assets which a bank owns in excess of the sum of 20 per centum of its demand deposits and 6 per centum of its time deposits: (A) Coin and currency in its vault or on hand, (B) demand deposits due from other banks to the extent that they exceed demand deposits due to other banks, (C) deposits with a Federal Reserve Bank (and the Reserve Banks are authorized to receive such deposits from any bank), and (D) cash items received in the ordinary course of business which are in process of collection and are payable immediately upon presentation in the United States.

'(e) Computations. - For the purpose of determining the amounts and percentages specified in subsections (c) and (d) of this section, each bank shall compute all such amounts on an average daily basis covering monthly computation periods or such other computation periods, not shorter than weekly periods, as the Committee may prescribe; and the Committee may prescribe different computation periods for different classes of banks, classified according to size or location or other reasonable basis. The amount by which the average daily amount of special reserve assets owned by a bank in any computation period falls below the amount required by this section or regulations pursuant thereto shall be considered a "deficiency" for such computation period.

'(f) Penalty for Deficiencies. - Any bank having in any computation period a "deficiency" as defined in subsection (e) of this section shall pay to the United States a penalty at the rate of one-half of one per centum per month upon the amount of such deficiency for such period. If such penalty is not paid to the Treasurer of the United States by the end of the month succeeding that in which such computation period

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"'ended, such penalty, together with interest thereon at the rate of six per centum per annum from the end of such succeeding month until paid, may be sued for and recovered by the United States in a suit to be brought by the United States District Attorney in the District Court of the United States of the judicial district in which the principal place of business of such bank in the United States is located, and the District Courts of the United States shall have jurisdiction of such suits. If and when the Committee shall so request, it shall be the duty of the several District Attorneys in their respective districts, under the supervision of the Attorney General, to institute proceedings to collect such penalties including interest. In unusual cases, when a bank has a deficiency which results from excusable error made in good faith, a certificate may be issued in the discretion of the Committee excusing such bank from payment of a penalty on account of such deficiency.

'(g) Reports. - The Committee may require banks to furnish from time to time such reports and other information as it may prescribe, but no such reports or information shall be required except such as the Committee may find to be necessary to obtain information as to compliance with this section or otherwise to enable it to carry out its functions under this section. Any person who shall knowingly make any false statement or report or give any false information or wilfully fail to furnish any report or information required under this subsection shall be guilty of a misdemeanor, and upon conviction shall be fined not more than $5,000, or imprisoned not more than one year or both; and the expiration of the provisions of this section shall not prevent prosecution for any such offense committed prior to such expiration.

'(h) Regulations and Administration. - The Committee may from time to time prescribe, amend or revoke regulations to effectuate the provisions of this section or to prevent evasion or circumvention of its purposes either by abnormal accumulations of deposits due to or from other banks or by other devices; and such regulations may, among other things, include definitions of the terms used in this section not inconsistent with the definitions contained herein or with the purposes of this section. Any function of the Committee under this section other than the prescribing of regulations and the determination of matters of general policy may be performed by such member, officer, or representative of the Committee as it may designate for the purpose; and in the administration of this section, the Committee

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"'may utilize the services of the Federal Reserve Banks and any other agencies, Federal or State, which are available and appropriate.

'(i) Definitions. - When used in this section, unless otherwise required by the context --

'(1) "Person" means any individual, partnership, corporation, business trust, association, or other similar organization.

'(2) "Bank" means any person having a place of business in any state or in the District of Columbia which is (A) a national bank, or (B) a person engaged in the business of receiving demand deposits and subject to supervision or examination by the State authority having supervision over banks (or by the Comptroller of the Currency in the case of the District of Columbia); but the Committee may by regulation exclude from such term persons which it deems not to be substantially engaged in the performance of functions customarily performed by banking institutions receiving demand deposits and also not to be within the scope of the purposes of this section.

'(3) The amount of any obligation of the United States in the form of a Treasury bill, certificate of indebtedness, or note means the amount of the book value thereof as determined in accordance with regulations of the Committee.

'(4) "Demand deposit" and "time deposit" have the meanings given such terms by regulations prescribed from time to time by the Board of Governors of the Federal Reserve System pursuant to section 19 of this Act.

'(5) "Month" and "monthly" refer to calendar month.'"

Upon motion by Mr. Evans, the draft of bill was approved unanimously, with the understanding that it would be transmitted by Chairman Eccles to the Chairmen of the Banking and Currency Committees with a letter reading as follows:

"In connection with any consideration which your Committee may give to the current problem of inflationary bank credit expansion, I am enclosing herewith a draft of a bill which the Board of Governors suggests for dealing with this problem. You may wish to have it introduced in the Senate."

Mr. Vest inquired whether a copy of the bill should not be sent to the Presidents of the Federal Reserve Banks and Chairman Eccles stated

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that further revisions of the memorandum on the special reserve plan had been prepared and were contained in a memorandum dated November 25, 1947, which could be sent to the Presidents but that the draft of bill should not be sent to them until after it had been introduced.

Secretary's note: A further revision of the memorandum was made under date of December 5, 1947, and the November 25 draft was not sent to the Presidents.

In discussions between Chairman Eccles and Under Secretary Wiggins and between Mr. Evans and Mr. Clark of the Savings Bond Division of the Treasury Department, the suggestion was made by the Treasury that it would be helpful to the Treasury savings bond program, in which the Board has a special interest, if the cost of printing a booklet relating to the program could be paid by the Board. The matter was discussed and it was the consensus that the Federal Reserve System had a special interest in the wide distribution of savings bonds and that, therefore, the Board would be fully justified in paying the cost of the booklet.

Upon motion by Mr. Evans, it was agreed unanimously to authorize the payment of vouchers submitted by the Savings Bond Division of the Treasury Department covering the cost of printing the booklet in an amount not to exceed $10,000.

Reference was made to a letter dated November 6, 1947, from the Chairman of the Auditing Committee of the board of directors of the Federal Reserve Bank of New York replying to the Board's letter of October

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21, 1947, concerning two matters discussed during the recent examination of that Bank. The reply indicated that the directors felt that the manner of investigation of a defalcation, which investigation had been carried on primarily by the operating departments of the Bank rather than the Auditing Department, was the one best designed in the case in question to ascertain the facts and protect the interests of the Bank. With respect to the question of per diem payments made by the Bank to a former Assistant Vice President while serving as assistant to the Secretary of the Treasury, the letter from the Auditing Committee stated that it had noted the views expressed by the Board of Governors and that, should a similar situation arise in the future, such views would have due consideration.

Mr. Vardaman had suggested that this matter be considered at a meeting of the Board for the purpose of deciding whether it would be advisable to discuss it with the Chairman of the Federal Reserve Bank of New York and with the Chairmen of all Federal Reserve Banks at the forthcoming Conference of Chairmen with a view to making clear the position of the Board on the two questions involved.

It was agreed that matters of this kind should be discussed on the basis of general policy rather than on the basis of specific instances of the kind referred to, and that therefore the subject should not be taken up at the forthcoming Chairmen's Conference.

There was also a discussion of whether there had been a sufficient number of instances of the kind referred to to justify the Board taking them up with the Federal Reserve Banks, and it was concluded that such action would not be necessary at this time.

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In accordance with the understanding at the meeting of the Board on September 4, 1946, that there would be brought up at a meeting of the Board the question of publication of postwar pamphlet No. 8, "Federal Reserve Policy," Mr. Evans referred to a memorandum prepared by Mr. Thomas under date of November 21, 1947, transmitting a copy of the proof of the pamphlet and recommending that it be published promptly. The proposed pamphlet contained the following papers:

Three Decades of Federal Reserve Policy by Karl R. Bopp
Impact of the War on the Member Banks, 1939-1946, by Robert V. Rosa
Selective Instruments of National Credit Policy by Carl E. Parry
Problems of Postwar Monetary Policy by Woodlief Thomas and Ralph A. Young

By unanimous vote, Mr. Evans was requested to discuss the publication of the pamphlet with Mr. Vardaman and, in the absence of opposition from him, the publication of the pamphlet was authorized.

At this point Messrs. Smead, Thomas, Vest, Leonard, Nelson, and Baumann withdrew and the action stated with respect to each of the matters hereinafter set forth was taken by the Board:

Minutes of actions taken by the Board of Governors of the Federal Reserve System on November 25, 1947, were approved unanimously.

Memorandum dated November 20, 1947, from Mr. Thomas, Director of the Division of Research and Statistics, recommending that E. A. Goldenweiser, a Consultant in that Division, be asked to assist with the Board's work on the present legislative program for an indeterminate

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period of time with compensation at the rate of $40 per day worked, with the understanding that traveling expenses, including per diem in lieu of subsistence at the rates appropriate for a Director of a Division, would be paid by the Board.

Approved unanimously.

Letter to Mr. Wiltse, Vice President of the Federal Reserve Bank of New York, reading as follows:

"In view of the recommendation contained in your letter of November 20, 1947, the Board of Governors extends to February 16, 1948, the time within which the Cranford Trust Company, Cranford, New Jersey, may accomplish termination of its membership pursuant to notice acknowledged by the Board May 16, 1947."

Approved unanimously.

Letter to Mr. Leach, President of the Federal Reserve Bank of Richmond, reading as follows:

"This refers to your letter of September 19, 1947 regarding the request of the Wachovia Bank and Trust Company, Winston-Salem, North Carolina, that, for the purpose of determining its average reserve requirements, it be permitted to submit semi-monthly reports of deposits covering all its offices except the one in Charlotte, in lieu of the weekly reports now required covering the deposits of all offices.

"In view of the fact that such a change would require an amendment to Regulation 'D', the Board questions whether it should be made. However, we would like to discuss the matter with you the next time you are in Washington, which presumably will be early in December."

Approved unanimously.

Letter to Mr. Volberg, Vice President of the Federal Reserve Bank of San Francisco, reading as follows:

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"In view of the recommendation contained in your letter of November 19, 1947, the Board of Governors extends to March 5, 1948, the time within which the Portland Trust and Savings Bank, Portland, Oregon, may establish the proposed branch in Park Rose, Oregon, as approved by the Board on April 16, 1947."

Approved unanimously.

Telegram to Mr. Knoke, Vice President of the Federal Reserve Bank of New York, reading as follows:

"Your wire November 25. Subject to approval of your Board of Directors, the Board approves a loan by your Bank to the Bank of France of approximately $84,000,000, such loan to be secured by 75,000 kilograms of gold earmarked in your vaults. It is understood that the loan is to be made on the terms and conditions outlined in your letter of November 21 as follows:

"(a) Interest to be at your rate of discount in effect on the date the loan is made;

"(b) The loan to be for three months with the tacit understanding that you would entertain requests for at least three renewals and that in case of a desired renewal at the end of one year, you would be prepared to review the situation and consider the possibility and advisability of further extension;

"(c) The amount to be advanced to be up to 98 per cent of the value of the gold to be held in your vaults as collateral.

"It is understood that the usual participation will be offered to the other Federal Reserve Banks."

Approved unanimously.

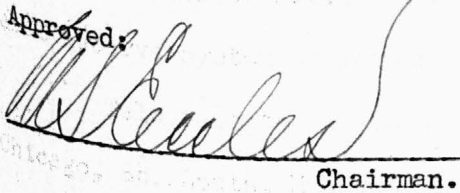
Memorandum dated November 25, 1947, from Mr. Parry, Director of the Division of Security Loans, recommending, for the reasons stated

in the memorandum, that $60 be added to the item of miscellaneous expenses in the 1947 non-personal budget of that Division.

Approved unanimously.

Secretary.

Approved:



Chairman.

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