Minutes of actions taken by the Board of Governors of the Federal Reserve System on Friday, April 2, 1948. The Board met in the Board Room at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman pro tem.
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Vardaman

Mr. Sherman, Assistant Secretary
Mr. Hammond, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Board
Mr. Smead, Director of the Division of Bank Operations
Mr. Thomas, Director of the Division of Research and Statistics
Mr. Vest, General Counsel
Mr. Nelson, Director of the Division of Personnel Administration
Mr. Young, Associate Director of the Division of Research and Statistics
Mr. Townsend, Associate General Counsel
Mr. Millard, Assistant Director of the Division of Examinations

There was presented a telegram to the Federal Reserve Bank of Philadelphia reading as follows:

"Retel April 1, Board approves effective April 2, 1948, rate of 1-1/4 per cent on purchases of Government securities under resale agreement as authorized by Federal Open Market Committee. Otherwise Board approves establishment by your Bank, without change, of rates of discount and purchase in Bank's existing schedule, advice of which was contained in your telegram dated April 1."

Approved unanimously.

There were presented telegrams to the Federal Reserve Banks of New York, Atlanta, Chicago, St. Louis, and San Francisco stating that the Board approves the establishment without change by the Federal Reserve Bank of San Francisco on March 30, by the Federal Reserve Bank of St. Louis on March 31, and by the Federal Reserve Banks of New York, Atlanta, and Chicago on April 1, 1948, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Mr. Vest stated that, after the Board's letter of March 24, 1948, with respect to the report of the Senate Banking and Currency Committee to the Senate on bill S. 2287 to amend the Reconstruction Finance Corporation Act, reached Senator Tobey's office, he (Mr. Vest) received a telephone call from Mr. L'Heureux, Chief Counsel to the Committee, asking for additional information. After discussing the matter, Mr. L'Heureux said that the report of the Committee did not make its position clear with respect to S. 408, which bill, previously reported out favorably by the Committee, would provide for the guarantee of business loans by the Federal Reserve Banks, and that he (Mr. L'Heureux) planned to suggest to Senator Tobey that he clarify the Committee's position on S. 408 in a speech he was to make in the Senate. Mr. Vest said that Mr. L'Heureux also mentioned that he was thinking of suggesting to Senator Tobey an amendment to the Reconstruction Finance Corporation Act which would provide that the Corporation could not grant loans to business enterprises unless application for the loan previously had been made to a Federal Reserve Bank and rejected. The purpose of such an amendment, Mr. L'Heureux explained, would be to avoid the possibility of duplication and competition between Government agencies in this field.

During a discussion of the matter the view was expressed that the amendment mentioned by Mr. L'Heureux would not be desirable and, for reasons discussed, that the Board would prefer not to have it suggested, but that it would be highly desirable if Senator Tobey, in a statement on the floor of the Senate, would clarify the Committee's position with respect to S. 408.

> Upon motion by Mr. Draper, it was agreed unanimously that Mr. Vest should talk with Mr. L'Heureux along the lines discussed.

Reference was made to a draft of letter for Chairman Eccles' signature to Senator Tobey, Chairman of the Banking and Currency Committee, with respect to housing legislation. The draft was prepared in accordance with the action taken at the meeting of the Board on March 30, 1948, and a copy was furnished each member before this meeting. The members of the Board expressed general agreement with the content of the letter, which opposed the enactment of legislation to continue and liberalize certain provisions of the National Housing Act which were considered to be inflationary, and Chairman Eccles and Mr. Szymczak suggested some changes of wording in the draft.

Following the discussion, upon motion by Mr. Vardaman, it was agreed unanimously that the draft should be changed in the light of the discussion at this meeting and that, when it was in form satisfactory to Chairman Eccles, it should be sent to Senator Tobey.

Secretary's Note: The letter for Chairman Eccles signature was sent to Senator Tobey under date of April 5, 1948, in the following form:

"The Board has been advised that your committee is considering general housing legislation, particularly S. 2317, introduced by Senator McCarthy, and amendments to S. 866 proposed by Senator Flanders.

"The Board is in sympathy, of course, with the major objectives of such legislation, and is in accord with some of the provisions of these bills. We feel, however, that in view of the broad responsibilities of the Federal Reserve System in the field of credit, we should call attention to several undesirable features of the proposed legislation, some of which we have had occasion to comment on previously. In this connection I am enclosing a copy of our statement of November 25, 1947 on Housing Finance to the Joint Committee on the Economic Report.

"The prospect for inflation is even greater now than it was last November. There is still a shortage of many goods in relation to the level of income, and, because of the imminent reduction in taxes, coupled with our commitments under the European Recovery Program and the recent program calling for a large increase in military expenditures, the Government must anticipate a deficit rather than a surplus. There is thus additional reason for the Government to take all steps possible to reduce inflationary pressures, particularly those generated by an excess of credit.

"For these reasons the Board is opposed to some of the provisions of the bills before your committee which would intensify inflationary pressures by making additional credit available and thus increasing the demand for building labor and materials. In addition, some of their provisions would reduce the capacity of the fiscal and credit "agencies of the Government to cope with either further inflation or future deflation.

"The Board is particularly concerned about three proposals contained in these bills: first, creation of a Government-financed secondary market for mortgages already underwritten by the Government; second, continuation of the undesirable mortgage-insurance program under Title VI of the National Housing Act; and third, addition to Title II of the National Housing Act of a permanent program of excessively easy mortgage credit.

"Creation of a Government-financed secondary market would be directly inflationary at this time, because, by making available $500,000,000 for the purchase of mortgages, it would represent added Government spending and increased demand for new housing which is already excessive, considering the available supply of labor and materials. Furthermore, one of the objectives at the time the Government mortgage insurance and guaranty programs were instituted was to eliminate the need for direct mortgage lending by the Government, partly by removing some of the risks to lenders and increasing the negotiability of mortgages. If private lenders are unwilling to hold or buy guaranteed and insured mortgages, perhaps the solution is to improve the quality of the mortgages or increase the return to levels which make mortgages attractive compared with other investments.

"Title VI of the National Housing Act, by making credit available on excessively easy terms, has contributed to the large rise in house prices and building costs, and has encouraged buyers to go too deeply into debt. We believe that both builders and buyers should have larger equities in their properties in an inflationary period like the present, and that it is both feasible and desirable to return to the terms offered under Title II as far as mortgages on houses for owner-occupancy are concerned. The Board has no objection to the continuation of Title VI for rental housing, provided safeguards are maintained against excessive loans in relation to value.

"Several of the proposed changes in Title II of the National Housing Act are subject to the same criticism as the present Title VI program. Mortgages on small "houses for 95 per cent of value and running for 30 years are excessive and so also are 40-year mortgages of 90 and 95 per cent of value for rental housing.

"Basically, these three proposals are of a type which would be appropriate for combating a serious deflation, and are the opposite of those appropriate in an inflationary situation such as we face today. Measures such as these should be reserved to cushion deflation should it later develop. Otherwise, the only measures available would be direct Government lending or subsidies, on a large enough scale to protect the real estate and housing market from a serious collapse such as developed in the early thirties."

There was then presented a memorandum from Mr. Carpenter dated March 25, 1948, transmitting a suggestion that the daily list of memoranda and publications include notice of visits to the Board by officers and directors of Reserve Banks. The memorandum had been circulated among the members of the Board before this meeting and the matter was on the docket at the request of Mr. Vardaman.

In commenting upon the suggestion, Mr. Vardaman said that he found the daily list extremely valuable in its present form, that it should not be changed into a news summary, and that notice of the visits mentioned was important but should be given by the Secretary's Office separately.

At Mr. Vardaman's suggestion, the proposal was referred back to the Secretary's Office with the understanding that that Office would arrange to notify the members of the Board of prospective visits of officers and directors of Federal Reserve Banks without putting the information on the daily list.

Reference was made to a memorandum from Mr. Smead prepared under date of March 23, 1948, with respect to the thickness of vault walls to be authorized for Federal Reserve bank branches. Mr. Smead said that in its letter to the Federal Reserve Bank of Atlanta on January 19, 1948, the Board stated that it would approve the construction of vault walls having a thickness of not more than 24 inches, and that similar information subsequently was furnished to the Federal Reserve Banks of Chicago and San Francisco, which were also working on plans for construction of new vaults at branches. He went on to say that in an informal conversation Mr. McLarin, President of the Atlanta Bank, indicated he would not seriously disagree with the request that vault walls of the Jacksonville Branch building not exceed 24 inches in thickness, and that Mr. Young, President of the Chicago Bank, stated that their original recommendation for four-foot walls at the Detroit Branch building had been modified and that 30 inch walls for the new vault were now recommended. He also said that Mr. Earhart of the San Francisco Bank stated that his directors recommended 36 inch walls for vaults to be constructed at the Los Angeles, Portland, and Seattle Branches but that they would have no objection to 24 inch walls if the Board wished to take the responsibility for deciding that walls of that thickness were adequate.

Chairman Eccles said that the Board had taken a position with respect to the thickness of vault walls of branches because, for reasons which he outlined, it felt some limitations were needed to avoid unnecessarily large expenditures which might result if recommendations of architects were accepted without question, that vault walls should be sufficient to provide reasonable protection against fire and ordinary theft, that he felt the Board should not undertake to determine the specifications for vault walls in individual cases such as was implied in Mr. Earhart's statement, and that he would be very reluctant to approve vault walls of more than 30 inches in thickness built of reinforced concrete without steel lining.

Mr. Vardaman stated that in making its recommendation the San Francisco Bank had taken into consideration the fact that some parts of the Pacific Coast were subject to earthquakes, and Chairman Eccles stated that perhaps special conditions might warrant a wall of more than 30 inches in thickness, but that as a general rule such thickness should be ample to protect against fire or ordinary burglary or theft.

There was a further discussion of the matter, following which it was agreed unanimously that Mr. Smead should prepare drafts of letters to the Atlanta, Chicago, and San Francisco Banks setting forth the above views for the consideration of the Board.

There was then presented a memorandum from Mr. Nelson prepared under date of February 2, 1948, with respect to leave policies of the Federal Reserve Banks which contained the following conclusions and recommendations:

> "Conclusions and Recommendations
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> "The rules now in effect at the Reserve Banks with respect to vacation leave evidence a conservative attitude, and are all not more than one month in each calendar year. It is therefore recommended that no changes be required in these rules.
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> "All of the Federal Reserve Banks keep in close touch with the use of the sick leave privilege and it does not appear to be abused. However, some of the Banks have sick leave regulations which, in certain classes of cases, seem unnecessarily liberal and it is suggested that such cases be taken up with the President of each Bank concerned, with a view to having the maximum allowance for sick leave in the regulation limited to six months in any two-year period and with the understanding that any exceptional cases exceeding such limitation be submitted to the directors or executive committee of the Bank for approval. It is, therefore, recommended that the Board's Personnel Committee be authorized to follow this procedure.
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> "In order to assist the Personnel Committee in considering the leave rules of the Banks it is recommended that the Board's examiners be instructed as a part of their existing procedure to report specifically any cases of sick leave granted in excess of six months in any two-year period and any cases of leave with pay for other purposes, including vacation leave, in excess of 26 working days in any calendar year, with the reasons."

Mr. Nelson stated that following the discussion at the meeting of the Presidents of the Federal Reserve Banks with the Board in June 1947, the Division of Personnel Administration studied the leave regulations of all of the Reserve Banks and found that a high degree of uniformity existed in their vacation leave schedules. With respect to sick leave regulations, he said that, although absenteeism because of illness was relatively low at the Federal Reserve Banks, the stated sick leave policies appeared to be unnecessarily liberal in some cases, especially since officers of some of the Banks were given discretion to exceed the authorized leave by as much as 50 per cent without obtaining the prior approval of the directors of the Bank or its executive committee, which might in extreme cases mean that individuals on sick leave would receive pay for as long as three years.

There followed a discussion of the leave regulations of the Banks as well as of the Board and of Government agencies operating under Civil Service, during which the view was expressed that although some of the Federal Reserve Banks appeared to have relatively liberal sick leave schedules there was nothing in the record of their operations to indicate that, in practice, sick leave privileges were extended more liberally than at the Board or in Civil Service.

Mr. Evans stated that the Personnel Committee, in recommending the adoption by the Board of the proposals in the memorandum, did not do so with the thought that the Federal Reserve

Banks were abusing sick leave privileges, but that the Committee felt it would be desirable to take up with the Presidents of the Banks concerned stated leave policies which seemed unnecessarily liberal and suggest that, since the Banks rarely found it necessary to apply such leave schedules to the maximum, it would be desirable to revise the stated policies so that the maximum allowance for sick leave would be limited to six months in any two-year period unless either the directors or the executive committee of the Bank had given prior approval for exceeding that limitation. He said that the Committee also felt the Board's examiners should continue to review leave taken by officers and employees of Federal Reserve Banks and report upon any cases of absences in excess of 26 days during a calendar year.

Following a discussion of the matter, upon motion by Mr. Evans, it was voted unanimously to approve the recommendations contained in the memorandum.

An outline of Chairman Eccles' proposed testimony before the Joint Committee on the Economic Report, before which he had been asked to appear on April 7, 1948, was considered. Chairman Eccles stated that there was not enough time to prepare the testimony adequately, that he understood Senator Taft, Chairman of the Committee, was to be out of town on April 7, and that he thought he should try to have a later date set for his appearance before the Committee. He reviewed the background of the present inflationary situation and stated why, in his opinion, it was important that the banking system not be given the opportunity for deposit expansion that it had during the war, and he discussed some of the specific recommendations for influencing credit which were contained in the outline and which he contemplated presenting in his statement to the Committee. He also expressed the opinion that in speaking before the Committee a proper view of the credit situation and of the Board's position with respect to it could not be given without a frank consideration of the bearing of the international situation upon domestic conditions. Chairman Eccles emphasized that the inflationary pressures which would arise out of a military program of the type recently announced were not ones that would be solved by credit controls alone, and he said he felt the Joint Committee should be so advised. He also said that he would like to make it clear to the Committee that the Board felt it should bring the situation to the attention of the Congress so that the Congress would not be under the impression that the Board now had authority which would enable it to protect the economy from the inflationary pressures of a prolonged armament race.

It was agreed unanimously that (1) Chairman Eccles should, if possible, obtain postponement of his appearance before the Joint Committee on the Economic

Report for about a week and (2) he should prepare a statement for submission to the Committee which would incorporate the substance of the views of the Board discussed at this meeting.

Secretary's Note: The statement submitted by Chairman Eccles when he appeared before the Joint Committee on the Economic Report on April 13, was as follows:

"When I testified before this Committee last November 25, I emphasized that I was speaking only for the Board of Governors of the Federal Reserve System. In presenting a further statement today covering the monetary and credit situation as it has developed in the intervening four months, I am again speaking only on behalf of the Board.

"We, of course, do not participate in the Government's military or rearmament planning or in the formulation of programs for foreign relief. Accordingly, what the Board has authorized me to say with regard to the impact on our economy of military and relief expenditures is said solely from the standpoint of the implications so far as monetary and credit policies are concerned. We feel that in any effort to deal with monetary and credit problems under the situation now existing, we should clearly recognize the alternatives before us and the economic consequences of expanding military outlays superimposed upon the present large budgets for military purposes and for our program of world aid.

"Never in our memories has the world been pervaded by greater fears, confusion, and discouragement, arising chiefly because of the disappointments of the past and the uncertainties of the future. The great hopes we had during the war for achieving a lasting peace in a prosperous world have been steadily diminished because a few ruthless and despotic men hold a sword of Damocles over the heads of free peoples throughout the world. It is difficult, if not impossible, to plan for a rational economic future either at home or abroad while that sword hangs over us.

"We think that the prospect of removing the threat by peaceful means will be immeasurably enhanced the "sooner we assert our moral and physical power to establish the foundations for peace before we are engulfed by the economic and social problems which grow more menacing the longer the establishment of a firm basis for permanent peace is delayed.

Monetary Situation in November

"Last November the country was faced with rapidly mounting inflationary pressures. The issue then was how to curb inflationary forces by striking directly at the basic cause, namely, an effective demand--composed of spending out of past savings, current income and new credit--in excess of the over-all supply of goods and services. As pointed out in the Board's statement to this Committee, correction of inflation at its advanced stage had to be on a broad front; fiscal policy had to be our main reliance; and monetary and credit policy was supplementary to other fundamental actions. The Board felt then, as it feels now, that effective monetary and credit policy would require legislation to provide the Federal Reserve System with new powers that would serve as a partial substitute for those traditional powers which had become largely unusable in view of the huge public debt.

"The essential monetary fact in the inflationary situation at that time was the amount of liquid purchasing power in the hands of the public, that is, currency, bank deposits and Government securities, aggregating in all about 254 billion dollars, or more than three times the amount held in 1940. This amount of cash or cash equivalent was in large part inherited from the financing of the enormous Federal deficits incurred in preparation for and prosecution of global war. Not only did we have this huge volume of cash or cash equivalent already available last November, but at that time, despite the anti-inflationary influence of the Government's large budgetary surplus, the amount of liquid funds was being rapidly increased as a result of bank credit expansion to finance businesses and individuals as well as State and local governments.

"Because of the necessity for protecting the Government's fiscal and debt management position by maintaining an orderly and stable market for Government securities, the Federal Reserve System was then and still "is unable to restrain effectively further monetary expansion. The commercial banking system held nearly 70 billion dollars of Government securities, which were being converted into additional bank reserves through sales to the Federal Reserve. In addition, the System was providing reserves to banks by purchasing Government securities sold by nonbank investors. Finally, bank reserves were being substantially augmented by a heavy inflow of gold.

"In brief, the banks at that time were in a position to supply unlimited amounts of additional credit, and in the face of strong demands for additional credit from all sources further rapid monetary expansion was occurring, intensifying existing inflationary pressures. This situation was potentially explosive because production and employment were close to the maximum then possible.

Changes since November

"Last November we expected some abatement of inflationary pressures in the first quarter of this year. Such a situation developed. It was recognized that there would be a large volume of funds drawn from the banks by business and individuals in order to pay taxes which would result in a large cash surplus available to reduce the public debt. It was also recognized that the existing and contemplated program of monetary and credit policy would have some restrictive effect. The program, which was carried out, included the statement by the bank supervisory agencies, urging the banks to be more restrictive, the lowering of Federal Reserve support levels for Government securities late in December, a slight rise in rediscount rates early in January, and some increase in reserve requirements for banks in New York and Chicago in February. The banking fraternity, recognizing the dangers in rapidly expanding bank credit and the need for restraint, undertook a nation-wide educational program to bring about restriction by voluntary means. Finally, there was a widespread belief that the supply of goods in many fields was gradually catching up with deferred demands and that favorable crop developments would combine to lessen inflationary pressures by the spring of this year.

"Monetary developments since November have accorded generally with expectations held at that time. Fiscal and monetary operations together effectively offset factors increasing bank reserves during the period, such as "the inflow of gold, return of currency from circulation and purchase by the Federal Reserve of Government securities from nonbank investors. During the four-month period, December through March, the Federal Reserve purchased 8.6 billion dollars of Government securities, largely bonds, and sold in the market 6.3 billion of securities, chiefly bills and certificates. The Government retired 3.9 billion dollars of its securities held by the Reserve System. The net result of these operations was to reduce Federal Reserve holdings by 1.6 billion dollars and thus to keep the bank reserve positions under pressure during this period.

"The combined effect on the money supply of Treasury and Federal Reserve operations, which were only made possible by the large budgetary surplus, was strongly anti-inflationary. The money supply was contracted by nearly 4 billion dollars. Commercial bank loan expansion was sharply curtailed, partly reflecting fiscal and monetary developments, partly reflecting the effectiveness of warnings by banking supervisors and the success of the bankers' own program of voluntary restraint, and partly reflecting the usual seasonal slack in business loan demand during the first quarter.

"Concurrently with these developments, the world crop outlook has become more promising and prices of farm products and foods have declined. In addition, productive activity generally has held close to maximum levels. These developments have exerted an anti-inflationary influence.

Prospective Monetary and Credit Situation

"Notwithstanding these salutary developments, it cannot be said that inflationary dangers have been removed. Farm prices, though lower than they were, still continue firm, even though at present levels they are much higher relatively than prices of most other commodities. Current and backlog demands for many goods continue to be very strong. Prices of industrial products, wages, rents transportation and some other services are still advancing. The money supply, though contracted by an estimated 4 billion dollars, remains excessive in relation to total product. Public holdings of cash or cash equivalent available for spending are nearly as large as last fall--250 billion dollars compared with 254 billions--and continue to be broadly "distributed among holders. Commercial banks, though obliged to sell some securities to offset shrinking deposits, still hold 66 billions of Government securities, which are readily convertible at the banks' discretion into reserves. Upon these reserves a six-to-one expansion of bank credit and deposits can be built. To the extent that the monetary gold stock is increased and Government securities are sold to the Federal Reserve by nonbank investors, still more reserves would be created. These additional reserves could also support an inflationary six-to-one expansion of bank credit.

"On the basis of the monetary situation alone, there would still be a dangerous inflationary potential, even if no further impetus were given to inflationary pressures by other forces. However, upward pressures are now in prospect as a result of several important new factors. One of these is the tax reduction bill. This bill will add about 5 billion dollars to the purchasing power of the public and take away a like amount from Federal revenues in the next fiscal year. The international financial obligations which we have now accepted are another factor likely to add many billions to Government expenditures in the future. The expanding program of military preparedness will further increase the budget burden for next year and future years by still more billions. Stemming from these developments, on top of existing inflationary conditions, is a rapidly changing public psychology with respect to the inflationary outlook.

"Businesses and consumers will be more disposed to use existing liquid resources and to expand their borrowings to finance current expenditures. The prospect is that the demand for new financing, aside from Government requirements, will exceed the supply of available savings. This would mean that many in need of financing will turn to the banks for credit. A growth in the total volume of bank credit and money, under such a situation, can only add to inflationary pressures. Moreover, these pressures would be aggravated if the demands of the defense and foreign aid programs for goods which are already in short supply further reduce the quantities available to the public.

"The Government's fiscal operations for the balance of the calendar year 1948 are likely to show a budgetary "deficit which would eliminate the only remaining important anti-inflationary influence. During the last three quarters of the year, it is estimated that the budgetary deficit may exceed 3 billion dollars. (In view of large tax receipts in the first quarter of 1949, however, there may be a small budgetary surplus for the twelve-month period beginning with April 1 of this year.) It is also estimated that continued sales of savings bonds and other public debt receipts will approximately cover voluntary redemptions of public debt by holders of maturing issues. The current deficit will need to be financed by drawing on Treasury deposits which have been built up by tax receipts during recent weeks, or by borrowing in the market. Under these circumstances, there can be no net retirement of Government securities held by the Federal Reserve System. To the extent that the Treasury may need to borrow new money, it probably will have to be obtained largely from the banking system.

"During the next few months Treasury use of accumulated balances with Federal Reserve Banks will add to bank reserves, which will also continue to be augmented by the inflow of gold and possibly by further Federal Reserve purchases of Government securities from holders wanting funds for other uses. These last two factors may operate for a long time in the future. If the international outlook does not improve, Government deficits may continue and even increase substantially, and banks may be called upon to purchase additional Government securities. Under these conditions, the Federal Reserve would find it difficult, and perhaps impossible, to sell Government securities in order to absorb bank reserves without seriously upsetting the market for such securities.

"Prospects are, therefore, that in the future gold inflow and Federal Reserve purchases of securities in maintaining an orderly market for long-term Treasury bonds will further increase bank reserves. Banks would thus be in a position to expand loans and investments for private purposes and this would mean still more inflationary expansion of the money supply. To restrain such potential expansion, the Federal Reserve would have to take action to absorb any excessive volume of reserves. Two types of measures should be adopted: (1) Interest rates on short-term Treasury securities and discount rates should be permitted to rise to the extent possible "without raising rates on long-term bonds; and (2) To the extent that this action is not adequately restrictive, the Federal Reserve should have the power to increase reserve requirements substantially to cover at least any growth in the total supply of reserves.

"The first of these measures, which could be adopted by the Federal Reserve and the Treasury without any new legislation, would be designed to induce banks to purchase short-term Government securities and to discourage extension of credit to private borrowers. Policies during the past year have moved in that direction about as fast as is feasible without unduly upsetting the market. There are limits, however, to such a course. Short-term rates probably cannot be raised much more without unsettling the $2\frac{1}{2}$ per cent rate for long-term Treasury bonds. Moreover, it is doubtful how much any rate that is feasible will deter banks from making loans to private borrowers or purchasing higher rate securities.

Need for Additional Powers

"Accordingly, the Board believes that the System should be given authority to increase the reserve requirements of all commercial banks. For the present this authority should make it possible for the System to require all commercial banks to maintain primary reserves with the Reserve System amounting to 10 per cent of aggregate demand deposits and 4 per cent of time deposits in addition to present requirements. This would give to the Reserve System power to increase bank reserves in the aggregate by a maximum of about 12 billion dollars. An authority of this amount would enable the System to absorb the reserves that are likely to arise from gold acquisitions or from necessary System purchases of Government securities sold by nonbank investors over the next few years.

"In case banks should persistently follow the practice of selling Government securities to the Federal Reserve in order to expand private credits, notwithstanding higher short-term interest rates and increased primary reserve requirements, then the System should be granted supplementary authority to impose a special reserve requirement along the lines proposed by the Board last November. This type of authority may be described as an optional reserve requirement because it could be held, "at the option of the individual bank, in specified cash assets or in short-term Government securities.

"The maximum requirement under this plan could properly be limited to 25 per cent of aggregate demand deposits and 10 per cent of time deposits. To be effective and equitable, it should apply to all commercial banks. A detailed description and analysis of the Board's special or optional reserve proposal was submitted to the House Committee on Banking and Currency and has been published in the Federal Reserve Bulletin.

"To the extent that it may become necessary to rely upon the banks for any new Government financing operations, the optional reserve requirement would be an especially valuable instrument. And in the case of large-scale deficit financing, it would be essential. In such financing, it would be advisable to make available to banks only short-term securities. Application of the optional reserve requirement would have the effect of immobilizing these securities so that they could not be used to obtain reserves to pyramid new bank assets upon them on a six-to-one ratio. In other words, securities issued in new Treasury financing through banks would be tied to the deposits created by their purchase. A ready market for short-term Governments would be assured and the Treasury would be helped in successfully carrying out both its refunding operations and its deficit financing. At the same time, the Federal Reserve would be enabled to exercise some restraint upon the money market for private credit.

"The dominance of public debt in the present credit situation has rendered the System's traditional powers generally unusable for purposes of restraining further inflationary credit expansion. The Reserve Board is not now seeking additional power beyond what it formerly possessed; it is merely pointing out that the System has little or no authority to deal with the credit situation as it currently exists and seems likely to develop. If the Congress wants the Federal Reserve System to perform the functions for which it was established, the System must have a substitute or at least a partial substitute for those powers that have become unusable. The Board feels that it would be remiss if it failed to bring this matter to the attention of Congress.

"There is no simple way of holding in check bank credit expansion in excess of essential public and private "need. The problem should be met in a combination of ways--by general credit controls and in particular areas by selective controls, such, for example, as reimposition of consumer instalment credit regulation, and the continuation of existing margin requirements on stock market credit.

Other Anti-inflationary Actions

"The Congress is currently considering continuance of easy mortgage credit for housing. Easy mortgage credit is one of the most inflationary factors in the domestic credit picture. At the very most Government mortgage credit programs at this time should be limited to relatively low cost housing, particularly for rental housing, and should be accompanied by some restriction on other less essential types of housing. The housing shortage cannot be overcome by increasing the competitive pressures on scarce supplies of materials and manpower. They are the limiting factors on the volume of construction. It is one thing to provide easy credit facilities to encourage special types of residential construction activity under a system of allocations and permits. It is quite another thing to provide such encouragement in a free market already characterized by heavy accumulated demands and by strategic shortages in supply that are likely to be intensified by the defense and world aid programs.

"In restraining inflationary pressures under present and prospective conditions, monetary and credit policies must be combined with fiscal and other governmental policies. The public should be given every possible assurance that the Government will protect the purchasing power of the dollar so that the public would be more willing to defer the satisfaction of wants, particularly for houses and durable goods.

"Wherever possible, Government expenditures that will add to pressures on the labor and capital goods markets should be deferred, and State and local governments should be requested likewise to defer nonessential expenditures of this type. There should be early action to close loopholes in our tax laws and to strengthen the tax collection machinery. If the stage is reached at which Government expenditures again threaten to create large budgetary deficits, then a reimposition of wartime levels of taxation and direct economic controls along the lines proposed by Mr. Baruch, for example, should be undertaken. If young "men are to be drafted into the military forces, then a way should be found to keep men at work in essential industries, and thus prevent the serious inflationery effects brought about by strikes.

Situation Now and in 1940

"The Board believes that any realistic appraisal of the economic outlook from the standpoint of monetary and credit policy must take account of the underlying facts of the international situation. During the war there was no doubt about the ultimate victory. The country looked forward confidently to an era of stability and peace following the hostilities. Nearly three years after the end of fighting, however, we seem to be farther away from these goals than ever. Our national debt still exceeds 250 billions, or more than five times the prewar total. Federal budgets have never fallen under 37 billions a year and we are confronted now with the prospect of an expanding debt and budgets. During the war we expected the peace to bring an end to these enormous drains on our resources.

"Today, there is no end point in sight. Threatening as the inflationary potential was at the end of the war, it is worse today. When we embarked upon the defense program in 1940 we had a tremendous slack in the labor force, with nearly 12 millions fewer employed then than now. We had surpluses of most raw materials, of unused industrial capacity, of housing, of foodstuffs, and of countless other things. The impact of our heavy armament expenditures was not inflationary so long as the total demand on our resources did not exceed capacity. It rapidly became inflationary as civilian purchasing power created by the expenditures began to exceed the available supplies of goods and services.

"We held the excess purchasing power fairly well in check while the war was on. We have now seen the consequences of premature removal of the harness of wartime controls. Even the one remaining anti-inflationary force, that is, a large budgetary surplus used to reduce our money supply, is no longer in prospect.

Over-All Policy Alternatives

"On the basis of present trends, we believe that the country, sooner or later, has to choose between three broad alternatives.

"First, we can continue on the present course of providing essential foreign aid and of carrying out a military "program on a scale of, as yet, undetermined size and cost, while at the same time we have no effective checks on the free play of economic forces. This is the certain road, if followed long enough, to a ruinous inflation. Surely no one would seriously contend that we can go on adding more and more pressure in the boiler of inflation without an ultimate explosion. Those who view us with a hostile eye no doubt hope that we will wreck our economy on the shoals of inflation. It would be a cheap way to defeat us.

"Secondly, the country could be subjected to a full harness of direct economic controls--for example, allocations, construction permits, rationing, price and wage controls, as well as taxation at higher levels. Without such a harness, amounting to a regimentation of the economy in peacetime, there is no sure protection against inflationary dangers that may lie ahead. They cannot be successfully combated by any single means or on any single front. There is no power that the Board now possesses or that the Congress could give us in the monetary and credit field that would be adequately effective by itself.

"Beyond that, we must ask ourselves whether the public would be willing in peacetime to submit to the sacrifices and rigid restraints of a wartime economy. If our preparedness program calls for a military draft upon our young men, should it not call also for control of the profits arising from that program?

"We may well ask for how many years must we maintain enormous and probably expanding military expenditures. The question is, how long, to what end, and at what consequences to our economy? We do not have the inexhaustible supplies of manpower and resources to support indefinitely, with no end point in sight, programs of the magnitude which we now are shouldering or contemplating. We cannot go on year after year bearing these crushing costs without jeopardizing what we seek to save. If we were confident of the early establishment of peace, we could tolerate a tightly controlled economy. We believe that the time element is the very essence of this grave problem.

"Our nation sought neither territory nor reparations in either World War. We seek neither now. We ask only for the earliest possible establishment of the foundations for enduring peace. To that end, our third and best course "may be to choose a combination of alternatives; that is to say, acceptance of such controls as may become necessary to prevent inflation at home while abroad we lay at the earliest possible moment the foundations for peace. Surely an informed public would be ready to accept even burdensome controls and taxation if convinced they are essential to safeguard our economy against a ruinous inflation, and that there is an early end point in sight which will enable us to maintain our system and our institutions in a peaceful world.

"To sum up the situation as the Board sees it, we are faced with the possibility that still further upward pressures will be added to the tremendous inflationary potential generated by war financing and intensified by subsequent developments. We should do everything possible within the existing authority of the Government to moderate and counteract these forces. Federal, State and local governments should practice the strictest economy and defer all public works and similar expenditures that can be postponed until there is a surplus of manpower and materials instead of the shortages that now exist. Every effort should be made not only to preach but to practice economy and savings at this time. The need still is urgent to spend less and save more--to invest in Government Savings Bonds. Every assurance should be given that the purchasing power of these savings will be protected.

"So far as the monetary and credit field is concerned, we have tried to make clear that action on these fronts alone cannot guarantee stability. Nevertheless, we believe that the Reserve System should be armed with requisite powers, first to increase basic reserve requirements of all commercial banks and, later on, if the situation requires it, to provide that all such banks hold an additional special reserve. Both of these would be protective measures. The first could be used to offset gold acquisitions and purchases of Government securities by the Federal Reserve, and thereby restrict continued expansion of our already excessive money supply. The second would be essential in case banks embark upon an inflationary credit expansion through the sale of Government securities to the Federal Reserve or to assist the Government in case of large-scale deficit financing.

"We believe it is the part of prudence to recognize clearly that the underlying cause of the continuing inflationary dangers arises from the disappointment of our great hopes for the early establishment of world peace. Surely we must summon all our human and material resources needed to assure that peace. If necessary to protect our economy at home so that we shall not lose by inflation what we seek most of all to save, we should be willing and prepared to reimpose to whatever extent the situation demands a harness of controls, including higher levels of taxation. Nobody wants such regimentation but in the hard choices before us it is infinitely preferable to economic chaos and possible collapse of our system, to which all free men look for deliverance from the evils of war and misery that feed on economic distress.

"We are aware that the questions of policy designed to achieve the cardinal purpose of assuring an enduring world peace are outside the domain of those charged with responsibilities in the monetary and credit field, but we feel that such responsibilities have to be exercised in the light of the burdens which the economy must bear. The earliest attainable settlement of the issues that now stand in the way of lasting peace offers the best hope for the preservation of our institutions and our freedoms. Meanwhile, they must not be jeopardized either by uncontrolled inflation or long continued regimentation at home."

At Chairman Eccles' request, Mr. Townsend reported to the Board on the status of the investigation to determine whether the Board should institute proceedings under Section 11 of the Clayton Act against Transamerica Corporation, which investigation was authorized at the meeting of the Board on October 31, 1947. Mr. Townsend observed that the nature of the Transamerica monopoly differed from instances of monopoly in other lines of business and that if the case advanced to the point of a hearing, it would be the first time that banking had been brought into antitrust litigation. He pointed out that the Board had no power of subpoena and consequently could obtain only voluntary evidence and testimony, that a great deal of material had been gathered by personal interviews with numerous bankers in the western States, and that a large quantity of statistical and other data had been accumulated at the Board's offices and at the Federal Reserve Bank of San Francisco since the investigation was authorized.

In discussing the information that had been accumulated, which included an extensive outline of the growth of the Transamerica interests from 1903 to the present, Mr. Townsend said that the work of analyzing the material and simplifying it for readier presentation was in process and that this would necessitate a trip by the members of the Board's staff working on the investigation to the Federal Reserve Bank of San Francisco in the near future so that the two sets of data could be integrated.

With respect to the probable results of the investigation, Mr. Townsend said that sufficient analysis had now been made to indicate that the Board would have material to justify bringing the contemplated action against Transamerica, but that he felt it was important to supplement that already gathered with statements of Pacific Coast bankers regarding their general attitude toward the growth of Transamerica, and he described the reasons why he felt such statements could be obtained.

In response to an inquiry from Mr. Evans, Mr. Townsend outlined the steps that probably would be followed in such a proceeding and stated that material might be ready to permit bringing an action, if the Board desired to do so, by late summer of this year. It was understood that a subsequent report would be made to the Board when further analysis of material had been made.

At this point all of the members of the staff excepting Mr. Sherman and Mr. Thomas withdrew.

Chairman Eccles referred to a memorandum prepared by Messrs. Thomas and Knapp under date of March 16, 1948, recommending that the Board approve a trip to France and Italy in May and June of this year by Mr. Albert O. Hirschman, a member of the Foreign Areas Section of the Division of Research and Statistics, for the purpose of visiting the central banks of France and Italy and for studying the developing fiscal and monetary conditions and policies in those countries. He said that the memorandum was transmitted to him by the Personnel Committee with the statement that the Committee would have no objection to approving the travel request if, in his opinion and that of Mr. Szymczak, the trip was justified. Chairman Eccles said that in connection with the work of the National Advisory Council and other work that the Board was doing, it was important that it have good information on such matters as central bank policies in the leading

European countries, that during the next several months exchange and fiscal problems in France and Italy would be especially important in connection with the European Recovery Program, that Mr. Hirschman was an expert on conditions in these countries, and that it seemed to him important that he be authorized to make the trip.

Mr. Evans stated that he was entirely agreeable to authorizing a trip for the reasons which Chairman Eccles outlined, and that he knew Mr. Hirschman and thought highly of him. He said that there was one other aspect to the matter which he wished to bring to the Board's attention, however, and that was the fact that some ten years ago Mr. Hirschman served in the Loyalist Army in Spain for a few months, that he was known to have many friends and acquaintances in France, some of whom probably also served in the Loyalist Army in Spain, that it was likely that some of these friends and acquaintances were active in opposition to the present government of France, and that there was a question in his mind whether, especially under present conditions, Mr. Hirschman should be sent by the Board to visit the central banks and ministries of finance of France and Italy unless the Board felt sure that no question would be raised by the governments of those countries concerning his acceptability. He added that this matter had not been discussed with Mr. Hirschman, that it might well be that none of Mr. Hirschman's friends were active in opposition to the present governments of France or Italy, and that he was bringing the matter up only because he felt the Board should be aware of the situation before authorizing Mr. Hirschman to make the trip. He also said that the question he had raised would be answered to his satisfaction if the Board obtained a letter from a high ranking official of the Department of State saying that that Department had looked into the matter of Mr. Hirschman's serving as a Board representative in France and Italy for the purposes outlined in the memorandum and that it felt he would be satisfactory for the mission.

The matter was discussed and there was general agreement with the view that, before authorizing Mr. Hirschman to make the trip, the Board should receive a letter from an official of the State Department, preferably from Mr. Willard L. Thorp, Assistant Secretary of State and the State Department's representative on the National Advisory Council, saying that Mr. Hirschman's visit would in no way be embarrassing either to this government or to the governments of France and Italy.

The meeting then recessed and reconvened at 2:25 p.m. with the same attendance as at the close of the morning session except that Mr. Knapp, Assistant Director of the Division of Research and Statistics, was also present.

The discussion with respect to Mr. Hirschman was continued and, in response to an inquiry, Mr. Knapp stated that Mr. Hirschman was the only expertly informed member of the International Section on France and Italy who was available and who could carry out the mission contemplated in the way it should be handled, that he felt it was highly important that the trip be made, and that he would be glad to discuss with Mr. Hirschman the questions that had been raised concerning the possible position of some of his former friends and acquaintances in relation to the governments of France and Italy. Mr. Knapp also stated that Mr. Hirschman, who had served in the U. S. Army during the last war, had been investigated by the Federal Bureau of Investigation and given clearance.

After further discussion, it was agreed unanimously that Mr. Thomas and Mr. Knapp should discuss Mr. Hirschman's proposed visit with Mr. Thorp of the State Department with a view to finding out whether the State Department would check into the matter and furnish a letter to the Board stating that it felt Mr. Hirschman would be a satisfactory official representative to these countries at the present time. In taking this action, it was understood that, if Mr. Hirschman was later authorized to make the proposed trip, he should be instructed to avoid meeting with or talking to any groups which might be considered objectionable by the present governments of France or Italy.

Reference was then made to a memorandum dated April 1, 1948, from Messrs. Thomas and Knapp recommending that Mr. Charles R. Harley, an economist in the Division of Research and Statistics, be sent on a trip to the United Kingdom in July or August of this year to observe and study economic and financial developments in the United Kingdom and to consult with officials of the Bank of England and the British government. The memorandum also recommended that, in accordance with provisions in the Standardized Government Travel Regulations, Mr. Harley be granted a per diem of $9 during the period he is in London.

> Upon motion by Mr. Vardaman, Mr. Harley was authorized unanimously to make the trip as outlined in the memorandum.

In this connection Mr. Evans stated that the Personnel Committee, which had the responsibility for passing on all travel requests, had not known of the request for a travel authorization for Mr. Harley prior to its presentation at this meeting of the Board, and he raised the question whether it was intended to by-pass the Committee.

In a discussion of the matter, Chairman Eccles stated that he felt requests for travel authorization in foreign countries should first go to the member of the Board having the assignment for initial consideration of foreign matters, but that he did not feel the present arrangement with respect to having the Personnel Committee pass upon all requests for travel before they were presented to the Board should be altered.

Mr. Szymczak stated that in the case of the request for Mr. Hirschman it had been submitted to the Personnel Committee before having been discussed with him and that he felt such requests should always be brought to the attention of the member of the Board having initial consideration of foreign missions before they were submitted to either the Personnel Committee or the Board.

Mr. Evans stated that he was not raising the question whether the member of the Board having the assignment for initial consideration of matters in a given field should be familiar with a request for travel authorization relating to such work before it was submitted to the Personnel Committee, but that he felt requests should not be submitted directly to the Board without going through the Personnel Committee if the present provision in the travel regulations was to be continued. It was the consensus that present travel regulations which provided for submission to the Personnel Committee of all requests for travel authorization were working satisfactorily and should be continued.

Reference was then made to a draft of letter to the Federal Reserve Bank of New York prepared in response to a letter from that

Bank dated March 19, 1948, setting forth a proposed foreign travel program for members of the staff of the Bank during the coming year. The letter outlined a program for (1) a three-month study trip (April-June) to England, France, Switzerland, Belgium, Netherlands, and possibly Germany by Mr. Walter S. Rushmore, Special Assistant in the Foreign Department, joined for the first six weeks or so (in London and Paris) by Mr. Arthur I. Bloomfield, Chief of the Balance of Payments Division, and for the rest (in Switzerland, Belgium, Netherlands, and possibly Germany) by Mr. O. Ernest Moore or Mr. Henry C. Wallich of the Research Department; (2) a trip to London and possibly to the Continent for about five or six weeks during the summer by Mr. Robert V. Rosa, a senior economist in the Domestic Research Division of the New York Bank; and (3) participation in the Conference of Central Banks of the American Continent at Santiago, Chile, in November.

The draft was discussed and, upon motion by Mr. Vardaman, was approved unanimously in the following form:

"Governor Szymczak has brought to the attention of the Board your letter of March 19, 1948 setting forth a proposed foreign travel program for members of your staff during the coming year.

"The Board has no objection to the program for visits to European countries outlined in your paragraph 1, and would be interested to receive reports concerning the results of these trips. It would also be appreciated if the members of your staff who are going abroad would "consult prior to their departure with the appropriate members of the Board's staff concerning the specific objectives of their studies in the various European countries.

"It may be mentioned that the Board has also been considering a travel program for members of its international staff. It has decided to send Mr. Charles R. Harley on a study trip to the United Kingdom in July or August, and is considering sending another man on a similar trip to France and Italy early this summer.

"With respect to the proposal contained in your paragraph 2 regarding a trip to London by Mr. Robert V. Rosa, the Board feels after careful consideration that in this case there is not adequate justification for the expenditure involved. In particular this trip would seem to involve some duplication with the Board's program in view of the plan referred to above of sending Mr. Harley of the Board's staff to the United Kingdom this summer.

"With regard to the prospective Conference of Central Bank Experts at Santiago, Chile, the Board expects that if such a conference is held, the United States Delegation would include representation from your Bank and from one of the other Reserve Banks, as well as from the Board. At the present time, however, it is the tentative view of the Board that the total number of the Delegation should not exceed four persons, of which two would be members of the Board's staff. It is suggested that this matter be reviewed by the Staff Group on Foreign Interests as the time approaches, with a view to making a recommendation on the subject."

At this point Messrs. Thomas and Knapp 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 April 1, 1948, were approved unanimously.

Letter dated April 1, 1948, prepared for Chairman Eccles' signature to Mr. Stephen J. Spingarn, Deputy Director, Office of

Contract Settlement, Treasury Department, reading as follows:

"In September 1944 the Board of Governors made available to Robert H. Hinckley, the first Director of Contract Settlement, sufficient space in the Federal Reserve building to house his organization. Some of this space has been in continuous use by your Office or the Appeal Board since that time. Following the issuance of Executive Order No. 9809 on December 12, 1946 transferring the functions of the Office of Contract Settlement and the Appeal Board to the Treasury Department, the greater part of this space was vacated. However, the Appeal Board has continued to occupy space in accordance with a letter dated March 17, 1947 from Gerald Maxfield, your predecessor as Deputy Director, and a reply dated March 18, 1947 from Mr. Bethea, Director of the Board's Division of Administrative Services. The substance of the arrangement was that the continued use of space in the Federal Reserve building by the Appeal Board was agreeable to the Board of Governors, subject to the understanding that the arrangement would be modified if any unforeseen contingencies arose during the ensuing year.

"Recently the Board of Governors was approached by the Commission on Organization of the Executive Branch of the Government for the purpose of obtaining space for its use in the Board's building. The Commission consists of twelve outstanding men drawn from the Executive and Legislative branches of the Government and from private life, including Herbert Hoover, Chairman, and Dean Acheson, Vice Chairman. In view of the importance of the Commission and its work, the Board feels it should cooperate to the fullest extent in meeting this request.

"Following a careful survey of its own space requirements, the Board has concluded that it can make available to the Hoover Commission 1,900 square feet of space by rearranging its own organization. The Appeal Board is now occupying 1,635 square feet of office space and has the use of a conference room and adjoining ante-room, aggregating 1,327 square feet or a total of 2,962 square feet. This space, together with the 1,900 square feet referred to above, or a total of 4,862 square feet is the minimum amount that will meet the requirements of the Hoover Commission. Accordingly, yesterday Mr. Bethea "orally advised Mr. Dimock, Chairman of the Appeal Board, regarding the Board's wishes in the matter and inquired whether the space could be vacated within the next thirty days. Mr. Dimock has suggested that the matter be taken up through you by letter.

"It has been a source of satisfaction to the Board to have been able to make available to your Office and the Appeal Board space in its building for more than three and one half years; in fact, there were mutual advantages in the arrangement at its inception and during the closing years of the war due to the Board's war loan and VT loan activities. Your official staff and personnel were accorded the same courtesies as those enjoyed by the Board's organization and relations with respect to day to day operations have been most cordial. It is therefore with reluctance that the Board requests that you arrange to vacate the space now occupied in its building not later than May 1, 1948.

"An early reply will be appreciated."

Approved unanimously.

Mr. Sherman then withdrew from the meeting and the Board went into executive session.

Following the meeting Mr. Sherman was informed by Chairman Eccles that the Board had authorized a special per diem of $12 for Mr. Townsend during his forthcoming trip to the West Coast in connection with the Transamerica investigation. Chairman Eccles also stated that the Board authorized the Personnel Committee to approve such additional payment to Mr. Townsend covering the period of his trip to the West Coast during March 1948 as they believed to be justified so that Mr. Townsend would not be called upon to pay a part of his travel expenses on that trip.

Assistant Secretary.

Approved:

Chairman pro tem.