A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Tuesday, November 15, 1949, at 10:30 a.m.

PRESENT: Mr. McCabe, Chairman  
Mr. Szymczak  
Mr. Draper  
Mr. Evans  
Mr. Vardaman  
Mr. Clayton  

Mr. Carpenter, Secretary  

Messrs. Spencer, Burgess, Potts, Congdon, Fleming, J. T. Brown, E. E. Brown, Hemingway, Atwood, Kemper, Woods, and Odlin, members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively.

Mr. Prochnow, Secretary of the Federal Advisory Council.

President Brown stated that at its meeting on November 13, 1949, the Federal Advisory Council approved the report with respect to the insurance of bank deposits submitted to the Board under date of October 5, 1949, by the special committee appointed by the Council pursuant to the suggestion made at the meeting of the Board of Governors and the Council on September 20, 1949.

Before this meeting the Council submitted to the Board a memorandum setting forth the Council's views on the topics to be discussed at this meeting. The statement of the Council and the discussion with respect to each of the topics was substantially
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as follows:

1. Coinage of gold.

What is the Board's opinion on the proposal now being urged to make currency redeemable in gold coin, and, specifically, what is the Board's opinion of the Reed Bill now before Congress which is designed to accomplish that purpose?

While the Council does not consider it feasible or desirable at the present time to make currency convertible into gold coin, it believes convertibility is a desirable objective of our monetary policy. The Council also believes it would be advisable to have a thorough study made to determine what preliminary steps should be taken toward this objective. In view of continuing public uncertainty regarding the power of the Secretary of the Treasury, one of the preliminary steps should be the revision of the Gold Reserve Act of 1934 to make it clear that the power to change the price of gold resides only in the Congress. Facing as we are the danger of a creeping inflation, the right to redeem currency in gold coin on demand would act as some check on a possible further deterioration in the purchasing power of the dollar.

President Brown stated that the Council was unanimously of the opinion that it was not feasible at the present time to resume the free coinage and circulation of gold, but that as long as the provisions of the Gold Reserve Act authorizing the Secretary of the Treasury to vary the price at which the Treasury would buy and sell gold remained in the law business men would be disturbed about the possibility of a change in the price. In those circumstances, he said, notwithstanding the recent statements of the Secretary of the Treasury and the President that there was
no intention to change the price of gold, it was believed to be important that the law be amended to make it clear that any change in the price of gold would require action by the Congress.

During a discussion of the authority of the Secretary with respect to the purchase and sale of gold as determined by the Gold Reserve Act of 1934 and the Bretton Woods legislation, Chairman McCabe expressed the opinion that if the amendments as proposed by the Council were suggested at this time it would open the whole policy question with respect to gold and that it would be preferable not to raise that question at the present time. He also referred to the answers which had been made to the questions asked by the Douglas subcommittee of the Joint Committee on the Economic Report with respect to increasing the price of gold and the free coinage of gold and stated that the members of the Board who were present at this meeting concurred in these answers.

Mr. Burgess stated that there was no difference of opinion between the Council and the Board as to the action that should be taken at the present time but that there was a fundamental difference on the question of the desirability of the domestic coinage and circulation of gold, the Council feeling that such a step at the proper time would be a valuable adjunct to an effective monetary system.
Mr. Fleming questioned whether the authority of the Secretary of the Treasury was so limited as in all circumstances to require the approval by the Congress of any change in the price at which gold could be purchased and sold, and this point was discussed.

President Brown suggested that the Board take steps to obtain an opinion of the Attorney General on the matter and Chairman McCabe responded that the Board would be glad to give consideration to that suggestion.

2. Economic and business conditions.

The Board would like to have the current views of the members of the Council regarding probable economic and business conditions during the next three to six months.

The Council believes that production and employment will remain at a high level in the months immediately ahead. There will probably be some decline in farm incomes and a decrease in private capital expenditures, but Federal deficit financing, insurance and bonus payments to veterans, capital expenditures by states and municipalities, and increasing industrial costs due to wage increases and pension programs (which will make for higher prices) will probably result in an over-all inflationary pressure in the economy.

President Brown stated that yesterday afternoon the Council listened to a report by Mr. Garfield, Chief, Business Conditions Section of the Board's Division of Research and Statistics, and that it appeared that the views of the Board's staff were
substantially in agreement with the views of the Council as set forth above. He also said that there appeared to be a genuine fear that prices would not decline but might move higher and that as a result inventories were being increased substantially. He also said that the members of the Council had not ventured a guess as to how long that situation would last.

Chairman McCabe summarized the views of the members of the subcommittee of the Committee on Research and Statistics of the Presidents' Conference as expressed at a meeting in Washington yesterday and there was a general discussion of prospects over the next three to six months and the probable effects of strikes in the coal and steel industries.

3. **System credit policy.**

What suggestions does the Council have to make regarding System credit policy during that period?

With the prospect for active business and with the inflationary forces now evidencing themselves, the Council believes the policy of the Reserve System should be toward firmer money. Through the use of open market operations and the re-discount rate, the Reserve System has ample powers to meet presently foreseeable problems.

President Brown stated that at the last meeting of the Council there was considerable discussion of the desirability of reducing the discount rate at the Federal Reserve Banks, that the Council was pleased that such action had not been taken, and that
the present tendency toward inventory accumulation and higher prices made it more desirable than in September that no action be taken to reduce rates as that would only add to existing inflationary forces.

Chairman McCabe stated that up to the present time the effects of devaluation of foreign currencies had not been as marked as was anticipated in September.

There was a general discussion of when the full effects of devaluation might be felt in this country, the probable level of capital expenditures and expenditures for plant modernization, and the need for such modernization and for revision of the tax structure to encourage investment. There was also a discussion of current policies with respect to inventory accumulation and turnover.

4. Treasury financing.

Does the Council have any further comments to make with respect to the December financing?

The viewpoint of the Council is the same as that expressed in its memorandum to the Board on September 20, 1949, which was as follows:

"The Council believes that the Treasury's announcement that it proposes to issue notes to refund the bonds coming due in December is a step in the right direction. As the program develops, it should include refunding into both intermediate and longer-term issues. Too
"large a proportion of the Federal debt is now in short-term securities, especially when considered in connection with the amount of savings bonds outstanding and with the steadily shortening maturities of the present long-term issues."

President Brown stated that the Council saw no change in the situation since last September which would call for a change in the Council's opinion on the December financing except its view that refunding should include some longer term issues was strengthened by the anticipated Treasury deficit during the current fiscal year. He also stated that apparently the Treasury would like to issue some longer term securities but because of the high prices at which outstanding maturities were selling in the market it would be difficult to issue such securities with any expectation that the price could be maintained without adverse effects on the economy generally. He added that the Council assumed that, in view of the announcement of the Treasury that the bonds maturing in December would be refunded into notes, the only questions left to be settled related to maturity and rate at which the refunding issue would be offered and that these questions would be determined on the basis of the market when the financing was announced.

Mr. Fleming concurred in President Brown's statement with the further comment that the Secretary of the Treasury was of the opinion that there was no need for a meeting of the Committee of the American Bankers Association on Government borrowing prior to
the December financing but that he had called a meeting of the Committee on December 15 and 16 when the problems of Treasury financing would be discussed.

Mr. Burgess stated that as long as longer term Treasury bonds were selling at present high prices, the Treasury was "trapped" and could not do what it was understood it would like to do; that is, refund some of the maturing issues with longer term securities, and that the question was whether some decline in long term security prices would not be wholesome as a check on municipal and business borrowing and to clear the way for longer term refunding.

In response to an inquiry from Chairman McCabe as to whether the Council felt that long term Government bonds should be sold from the System account, President Brown said that in discussions yesterday and the day before the members of the Council expressed the view that it would be helpful if restricted bonds could be sold from the System account more freely than was being done at the present time, that the market would take the bonds, and that the action would tend to check the decline in the long term rate.

5. Legislation.

The Board has been asked to submit to the President the legislative program affecting
the Federal Reserve System which the Board desires to have considered at the forthcoming session of Congress. The formulation of the Board's views on that matter is now in process and it would be glad to have any advice or recommendations that the Council might wish to make in that connection.

The Council is not advised as to what legislative program the Board may desire to have considered at the forthcoming session of Congress. However, the Council has discussed with the Board various legislative proposals on different occasions.

The Council has previously approved the following legislative proposals:

(a) Bank holding company legislation--The Council has on many occasions urged the passage of bank holding company legislation, and is now in favor of the passage of such legislation.

(b) Capital requirements for admission of state banks to membership in the Federal Reserve System, and for authority over the establishment of out-of-town branches of state member banks--In its memorandum to the Board on September 20, 1949, the Council favored H.R. 5749. The Council is still of the same opinion.

(c) Purchase by the Federal Reserve Banks of government obligations directly from the Treasury--In its memorandum to the Board on March 11, 1947, the Council made the following statement:

"The Council recommends that authority be given for a period of three years to make direct purchases up to 5 billion dollars from the Treasury. The Council believes that it would be advisable to review the matter again at the end of three years to determine
"if there had been any abuse of the power and also to determine whether the power should be further continued or be permitted to lapse. The Council cannot but be mindful of the fact that historically and in various countries direct borrowing by a government from the central bank has been a common vehicle of inflation."

The Council now recommends a renewal of this authority for a period of three years.

(d) Modification of limitation on the cost of Federal Reserve Branch buildings--The Council in the past favored, and now favors, repeal of paragraph 9, section 10, of the Federal Reserve Act.

The Council has expressed opinions on other legislative matters, as follows:

(1) Section 13b--In connection with Section 13b of the Federal Reserve Act, the Council stated in its memorandum to the Board on September 20, 1949:

"The Council is opposed to two government agencies having lending or guarantee powers in the same field and therefore would not favor giving additional guaranteeing powers to the Federal Reserve Banks in the industrial field."

The Council is still of the same opinion.

(2) Consumer credit--The Council has in the past stated that it does not believe the Board should in time of peace have powers over consumer credit. The Council remains opposed to the granting of such powers to the Board.

(3) Possible changes in the law with respect to bank reserves--

(a) The Council, as stated in its memorandum to the Board on September 20, 1949, is
"unanimously of the opinion that neither the Board of Governors nor any Federal agency should have authority to fix the reserve requirements of non-member banks."

(b) The Council believes that changes in reserve requirements should be used rarely and only for adjustment to basic changes in the monetary situation. In dealing with the question of bank reserves, it has often been forgotten that to build and preserve a sound banking system banks must have earnings sufficient to enable them to accumulate capital and pay adequate dividends. There should, therefore, be an upper limit on reserve requirements. The Council believes that the limits now in the law are as high as are tolerable, and give the Board sufficient power, with their other present instruments of policy, to deal with any foreseeable situation.

The discussion with respect to the Council's comments on legislation was substantially as follows:

(a) Bank holding company legislation. Chairman McCabe inquired whether the bill (S.2318) now pending before the Congress was acceptable to the Federal Advisory Council or whether it would have some further changes to suggest.

In the discussion which ensued the members of the Council stated that if the bill made it clear that there would be no tax liability in connection with the distribution or exchange of property in compliance with the provisions of the bill and that a bank would
not become a holding company if it held the stock of a trust company which did no commercial banking business, the Council would support the bill.

(b) **Capital requirements for admission to membership and the establishment of branches by State member banks.** There was no discussion of this topic.

(c) **Purchase of Government securities directly from the Treasury.** Mr. Fleming stated that when this legislation was being considered by the Congress in the past, it had been made clear that the authority had been used only occasionally during emergencies or tax payment periods and that it would be desirable if, when the matter comes before the Congress again, the limited extent to which the authority had been used could be pointed out.

(d) **Limitation on the cost of Federal Reserve Branch buildings.** The members of the Board outlined the extent to which commitments had been made against the $10 million authority for erection of Federal Reserve Branch buildings and the need for the repeal of the limitation in the existing law or an extension of the $10 million authority.

(e) **Industrial loans.** Chairman McCabe asked if the members of the Council had read his answer in the Douglas questionnaire on industrial loans by the Federal Reserve Banks.
President Brown responded that they had but were of the opinion that the limitation proposed in the answer on the authority of the Reconstruction Finance Corporation to make industrial loans would not be effective in reducing the volume of business done by the Corporation and might result in political pressure being brought on the Federal Reserve Banks to adopt more liberal lending policies.

Chairman McCabe stated that his suggestion would channel loans of the kind under discussion through the banking system rather than to the Reconstruction Finance Corporation and that he doubted that it would be possible to curb the present lending activities of the Corporation unless some satisfactory counter proposal could be offered.

There was a discussion of the effectiveness of the limitation on Reconstruction Finance Corporation lending proposed in the Chairman's answer to the Douglas questionnaire and the members of the Council reiterated the opinion that it would not be an effective curb.

There was a discussion of the operations and policies of the Federal Reserve Banks under their existing authority to make industrial loans, and Mr. Congdon stated that there had been occasions in the Cleveland district when the Federal Reserve Bank of Cleveland took a participation in a loan which was in excess of the legal limit of the participating commercial bank when a correspondent bank would have been willing to take the portion of the loan that the originating
bank could not legally make, and that it appeared to him to be wrong for the Federal Reserve Banks thus to compete with correspondent banks. Other members of the Council stated that the same situation had arisen in their districts and in a discussion of the question why a commercial bank would prefer to go to a Federal Reserve Bank rather than a correspondent bank it was stated that in some cases the small bank hesitated to go to its correspondent because of the fear that the latter would take the business away from the smaller bank.

President Brown stated that the lending policies of the Reconstruction Finance Corporation were very different today from what they were a number of years ago, that the present management of the Corporation was more responsive to political pressure, and that if the Federal Reserve Banks were to undertake to make loans of the type which the Reconstruction Finance Corporation was now making they would have to be much more liberal in their lending policies or the present situation would not be changed since the Reconstruction Finance Corporation was making loans which the commercial banks and the Federal Reserve Banks would not be willing to undertake.

Mr. Atwood inquired whether, if the Congress was willing to grant authority to the Federal Reserve Banks along the lines suggested in Chairman McCabe's answer to the Douglas questionnaire except for the proposed limitation on the activity of the Reconstruction Finance Corporation, the Board would be willing to accept such
Chairman McCabe said that this point had not been considered by the Board.

Mr. Kemper stated that there was no assurance that the satisfactory experience of the Federal Reserve Banks under the provisions of section 13b of the Federal Reserve Act would be repeated under the amended authority proposed by the Board for the reason that loans would not be made for as long as 10 years for any purpose and that would be an entirely different business from that done by the banks under section 13b. Furthermore, he said, there would be increased competition with correspondent banks because the smaller banks would find it to their advantage to go to the Federal Reserve Banks for participations in loans that were larger than the bank could make. He added that the proposed authority would subject the Federal Reserve Banks to political pressure to make industrial loans and would not be effective in curbing the lending activities of the Reconstruction Finance Corporation with the result that the legislation would establish another competitive lending agency and would be another step in the direction of socializing the banking system. During the discussion similar statements were made by other members of the Council.

Several of the members of the Council expressed the opinion that rather than liberalize the authority of the Federal Reserve Banks as proposed in the Chairman's answer to the Douglas questionnaire,
it would be preferable to leave the law in its present form until the performance of the Reconstruction Finance Corporation under its existing authority made it clear that the authority of the Corporation should be curbed.

Mr. Kemper added the further observation that if the authority of the Federal Reserve Banks was changed as proposed there was nothing to prevent a different Board adopting a different policy which would be in the direction of socialized credit.

Mr. Evans questioned whether there was much danger of political pressure being brought in connection with industrial loans by the Federal Reserve Banks because of the regional character of the Federal Reserve Banks and the fact that the loans which a Reserve Bank would make would be subject to approval by the Board of directors of the bank. The members of the Council were of the opinion, however, that that would not be an adequate protection.

In response to a question by Mr. Draper whether the Council felt that section 13b should be repealed, President Brown stated that the Council felt that as long as the Reconstruction Finance Corporation had authority to make industrial loans and there was no probability of curtailing the Corporation's activities, the Federal Reserve Banks should not have authority in the same field.

Chairman McCabe referred to the statement contained in his answer to the Douglas questionnaire to the effect that unless
Changes were made in the law to place the authority of the Federal Reserve Banks on a more effective basis, it would be preferable to repeal the present limited authority of the Federal Reserve Banks in its entirety. He added that it was his view that before that was done, however, an effort should be made to shift authority from the Reconstruction Finance Corporation to the Federal Reserve Banks, that the trend to the "left" would not be stopped by mere opposition, and that the only way to meet that trend was by the proposal of a sound alternative program.

The members of the Council indicated that while they would prefer to have the authority in the industrial loan field placed solely in the Federal Reserve Banks, they did not believe it would be possible to effect that change, and that in the circumstances it would be preferable for the Federal Reserve Banks not to have authority to make industrial loans.

There was some further discussion of the matter but no different conclusions were expressed.

(f) Consumer credit. Chairman McCabe read his answer to the Douglas questionnaire on this subject and in the ensuing discussion of the matter President Brown stated that the question involved in the differing opinions of the Council and the Board was whether authority over consumer instalment credit was a proper
instrument of credit policy.

(g) Bank reserve requirements. Chairman McCabe stated that in his answer to the Douglas questionnaire as to whether the effectiveness of Federal Reserve policy was reduced by the presence of nonmember banks, he had submitted as an alternative proposal the suggestion made by Mr. J. T. Brown at the previous meeting of the Council that all commercial banks be required to maintain the same percentage of reserves against deposits but that nonmember banks be permitted to count their balances with correspondent banks as reserves.

Mr. J. T. Brown stated that he noted that the suggestion was coupled in Chairman McCabe's answer with the further comment that if this improvement were all that could be achieved at the present time it would not be safe to give direct access to the credit facilities of the Federal Reserve Banks to all nonmember banks (as the answer proposed in the event reserve requirements were made uniform for all banks) but that it would be feasible to provide such access to all nonmember banks that chose of their own volition to carry the required reserves with the Federal Reserve Banks. He also expressed the opinion such an arrangement would be workable and said that it would be acceptable to him.

Mr. Congdon suggested that when the Board undertook to formulate its views with respect to changes in the law relating to
reserve requirements the Council be afforded an opportunity for a full discussion of the matter with the Board.

Mr. Burgess commented that such a discussion should include consideration of the earnings and capital position of banks, and that the principle reason for the opposition of banks to increased authority in the Board over bank reserves was the effect of increased requirements on bank earnings.

The members of the Board indicated agreement with Mr. Congdon's suggestion and Mr. Evans proposed that the Board's staff be requested to prepare a draft of statement which could be submitted to the Council in anticipation of such a discussion. All of the members of the Council stated that such an arrangement would be very helpful.


Are there any matters in connection with the questionnaires sent out by the Douglas subcommittee of the Joint Committee on the Economic Report that the Council would like to discuss with the Board?

Two members of the Council have been asked to testify before the Douglas subcommittee of the Joint Committee on the Economic Report. It is not possible in this written memorandum for the Council to express an opinion on all of the questions in the questionnaire of the Douglas subcommittee. Members of the Council will be pleased to comment on any of the questions, should the members of the Board desire their viewpoints.

President Brown inquired if anyone knew what objectives were
being sought by the Douglas subcommittee in sending out its questionnaires and holdings hearings on monetary, credit, and fiscal policies and no one had the answer to that question.

Mr. Burgess inquired whether the Board favored the creation of a National Monetary Commission and Chairman McCabe responded in the affirmative. Mr. Burgess said that the important point in the creation of such a commission would be the selection of qualified personnel to serve as its members.

Members of the Council commented that Chairman McCabe's answers to the Douglas questionnaire were a very useful piece of work and he expressed appreciation of the assistance that some of the members of the Council and others had given in submitting comments for his consideration in placing the answers in final form. He also stated that he appreciated the opportunity to work with the Council and while there had been differences of opinion at times they had always been on a friendly basis.

Some members of the Council stated that probably this would be their last meeting as members of the Council and that they appreciated the opportunity which they had had to serve in that capacity.

President Brown stated that the next meeting of the Council would ordinarily be held on February 19-21, 1950, but that since those dates were just prior to Washington's birthday, the time for
the meeting could be changed to February 12-14, if the Board of Governors should prefer. The members of the Board and the Council indicated that either time would be satisfactory to them whereupon President Brown stated that the next meeting would be held on February 19-21.

Thereupon the meeting adjourned.

Approved:

[Signature]
Chairman.