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 on Tuesday, May 16, 1950, at 10:35 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Eccles
Mr. Szymczak
Mr. Draper
Mr. Vardaman

Mr. Carpenter, Secretary

Messrs. Bucklin, Jackson, Congdon, Fleming, J. T. Brown, Edward E. Brown, Hemingway, Ringland, Beals, and Lochead, members of the Federal Advisory Council from the First, Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Twelfth Federal Reserve Districts, respectively.

Mr. Kurtz, who attended the meeting in the absence of Mr. Potts, a member of the Federal Advisory Council from the Third Federal Reserve District

Mr. Prochnow, Secretary of the Federal Advisory Council

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

1. <u>Economic and business conditions</u>.

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

All the members of the Council report that prospects in their districts are for a continuance of a high level of business activity and employment in the next six months. Construction, automobile sales, and steel production are at high levels. Retail sales are off slightly. Some sections of the country have experienced a late spring, with heavy rains, and retarded crops, whereas the lack of moisture in other areas has greatly reduced the size of the crops, especially wheat. But unless industry is disrupted by continuing railroad strikes, or other major labor disputes, general business activity for the last half of 1950 should be high, and profits of business enterprises as a whole should be good, although there may be considerable spottiness in different lines of business and among companies in the same line.

In response to an inquiry from Chairman McCabe, President Brown stated that the increase in consumer instalment credit had not reached alarming proportions, that the growth was largely due to the purchase of automobiles and appliances, and that the increase in mortgage credit arose principally from credit extended under the various housing credit programs of the Government.

During a discussion of the probable further expansion of credit during the rest of the year, and particularly of consumer instalment and housing credit, Chairman McCabe inquired whether the Council felt there was any point in the expansion of consumer instalment credit at which the Board would be justified in proposing to the Congress that the authority to regulate such credit be restored.

President Brown responded that the Council had not discussed that question, but that he felt the Council would be opposed to renewal of the authority, even if there should be a return of conditions similar to those existing in 1948. Comment by other members of the

Council confirmed President Brown's statement.

Mr. Bucklin stated that undoubtedly the banks, working through the American Bankers Association, and some of the larger finance companies could accomplish a great deal in eliminating the evils of excessively easy instalment credit if they were free to act without the danger of prosecution under the antitrust laws. It appeared from the comments of several members of the Council that they were not concerned with the volume or general soundness of consumer credit now outstanding and that in their opinion the current problem was one of easy terms growing out of competition.

Following a comment by Mr. Kurtz that he could foresee a condition under which the restoration of the authority to regulate consumer instalment credit would be justified, Mr. Fleming stated that in order for such regulation to be effective it would have to be accompanied by other actions restricting the current activities of the Government which encourage the expansion of credit in various ways. There would be no purpose, he said, in trying to curb the expansion of instalment credit when other activities of the Government were going in exactly the opposite direction and, as was the case with housing credit, were encouraging the growth of consumer instalment and other forms of credit.

In a short discussion of the problem of unemployment, Chairman McCabe reviewed the meetings which members of the Board and its staff had held recently with members of Congress of Industrial Organization unions from various parts of the United States where unemployment had been at a high level. He also read the letter which he addressed to Mr. Foley, Administrator of the Housing and Home Finance Agency, under date of April 20, 1950, in which he (Chairman McCabe) outlined reasons for the position that the maximum rate on Federal Housing Administration mortgages insured under Title II of the National Housing Act should not be reduced from $4\frac{1}{2}\%$ to $4\frac{1}{4}\%$ as was subsequently done. The members of the Council present indicated that they were in agreement with the position taken in the letter.

2. Treasury Financing.

> Does the Council have any suggestions to make to the Board with respect to the Treasury refunding program and the manner in which the deficit should be financed during the remainder of the current calendar year?

In view of the large percentage of the debt in short term maturities, and the steady shortening of the outstanding longer term maturities, the Council on various occasions has suggested the desirability of shifting a portion of the debt to intermediate and longer maturities. Market conditions now seem favorable for taking definite steps in that direction. The Council believes that long term ineligible bonds at a $2\frac{1}{2}$ per cent rate could be sold in considerable amounts and that a portion at least of the money required to meet the deficit should be raised by issuing such bonds. A portion of the refunding in the balance of the year should be done by bank eligible notes or bonds of intermediate maturities. The present practice of refunding and raising new money by bills, certificates and short term notes should be replaced by a policy of gradually extending the average maturity of the debt.

President Brown stated that the Council and the Board were in substantial agreement on the general question of the policy that should be followed in the refunding of maturing Federal debt, the desirability of flexibility in the short-term rate, and the support that should be given to Treasury bonds and notes. He also said that some of the members of the Council, as members of the American Bankers Association Committee on Government Borrowing, had seen the presentation of the Treasury staff in which the position was taken that there was no substantial amount of nonbank funds available for investment in long-term Government securities, and that the members of the Council were not in agreement with that position. On the contrary, he said, they felt that a long-term issue of marketable restricted bonds would attract between \$2 and \$3 billion of nonbank funds, that such an issue should be offered by the Treasury, and that an issue with a maturity in the neighborhood of 8 to 10 years should later be sold at a price which would not cause the offering to go to a premium. Such issues, he said, would attract a very considerable amount of corporate and other nonbank funds even though some of the securities found their way into bank portfolios.

Mr. Fleming stated that the recommendations made to the Treasury by the American Bankers Association Committee on Government Borrowing were along the lines outlined by President Brown. He added that it appeared from the presentation of economic and credit conditions to the Council by members of the Board's staff yesterday afternoon that there was a considerable volume of nonbank money that would be available for investment in Government securities if the proper issues were offered. He felt that a 20-25 year $2\frac{1}{2}\%$ restricted marketable bond would be a move in that direction.

Chairman McCabe stated the Board's position on Treasury financing substantially as follows:

"The Treasury will need to raise in the market over $1 billion to meet its cash needs during July, August, and September, in addition to net sales of savings bonds and notes, and will probably need at least 2 billion more in the last quarter of this year. Treasury financing should be carried out in as noninflationary a manner as possible in view of growing strength in the business situation. This objective can best be accomplished by offering securities designed to tap directly funds as they accumulate in the hands of nonbank holders. The availability of nonbank funds is indicated by changes in the distribution of the debt during the first four months of this year:

		Billions of Dollars
Total public debt (excluding holdings of Government agencies and trust funds)		0.6
Commercial and Federal Reserve Banks		- 2.6
Nonbank investors		3.2
Mutual savings banks	0.2	
Insurance companies	0.1	
Other corporations and associations	1.8	
States and local governments	0.2	
Individuals	0.9	

"The Treasury should, as soon as possible, set up machinery for tapping on a current basis accumulating funds of institutional investors and other large savers. For this, the Treasury should offer nonmarketable redeemable bonds not eligible for purchase by banks except to a lim-

"ited extent. The offering should remain open for an extended period of time. A nonmarketable issue with a 15-year maturity and a 2-1/2 per cent coupon might attract enough funds in June, July, and August so as to avoid any other public offering. This method of financing should at least be given a trial.

"In view of the business and credit situation, the Federal Reserve should have leeway for flexibility in its open market policies. Refunding of maturing issues, therefore, should be on terms which will not require special Federal Reserve support but will permit interest rates to reflect market forces. The Board agrees with the Council that the amount of short-term securities outstanding should be reduced. For this reason a portion of refunding issues should be in the form of intermediate and long-term notes. However, in view of the current economic prospects it would not be advisable to offer additional bank-eligible bonds in the near future.

"Should consideration be given to a restricted marketable bond which would be ineligible for banks, we should discuss the desirability of making it ineligible for Federal Reserve Banks also."

In the ensuing discussion, Mr. Eccles outlined the difficulties that would be involved in the issuance of a long-term restricted marketable bond and how a nonmarketable redeemable tap issue with a maturity of about 15 years would avoid these difficulties, particularly in the foreseeable future when there would be a considerable amount of deficit financing and when the System would continue to have responsibility for orderly market conditions and there could not be a very wide flexibility in interest rates.

Chairman McCabe stated that the suggestion that a long-term restricted marketable issue be offered by the Treasury had been presented before and had been given very thorough consideration by the

Federal Open Market Committee.

It was clear from the discussion that a nonmarketable tap issue of the kind referred to by Messrs. McCabe and Eccles was a new idea to the members of the Council and several indicated that they would favor such an offering and that there would be a very substantial demand for the issue.

Chairman McCabe stated that the manner in which the deficit was financed presented a very important problem, and that, therefore, the Council might consider the proposed tap issue and submit a recommendation which could be presented in confidence by representatives of the System at the time of further financing discussions with the Treasury. In that connection, there were distributed copies of a statement of possible redemption values that might be provided for the 15-year nonmarketable bond. Mr. Fleming asked if the securities could be made payable at par in the event of the death of the beneficial owner and Chairman McCabe said he thought that could be arranged.

President Brown stated that the Council would meet this afternoon to determine what its position on the proposed tap issue would be.

There were further references to the suggestion that, if a restricted marketable issue were to be offered, it be made ineligible for purchase by Federal Reserve Banks as well as by commercial banks. Some of the members of the Council expressed the view that consideration should be given to that proposal. One of the members stated that, with long-term corporate issues selling on a yield basis of 2.65 to 2.70, an offering of long-term restricted bonds which would be ineligible for purchase by Federal Reserve Banks would be attractive and might be one solution of the problem of how the System could be relieved of responsibility for supporting the long-term market.

3. Bank holding company legislation.

> The Board would like to discuss with the Council the current situation with respect to bank holding company legislation.

> The Council will be pleased to discuss with the Board the current situation relative to bank holding company legislation, and will appreciate the Board's views on the present status of the legislation. The Council is in general agreement with the Board that the substitute Robertson bill is not satisfactory.

President Brown stated that the Council was particularly interested in knowing the Board's views as to the probability of any legislation on this subject being enacted by the Congress during the present session, particularly since the information coming to the Council appeared to indicate that the bill was dead. He said that if there was any possibility of a bill being passed this year the Council would like to help the Board in any way it could.

Chairman McCabe reviewed the work that had been done by the Board during the past two years to draft a satisfactory bill and the circumstances which led up to the introduction by Senator Robertson of his substitute bill. He also said that while the Board understood that the Robertson Subcommittee had recommended that hearings be held before the Senate Banking and Currency Committee on the substitute bill and the amendments thereto which had been proposed by Senator Douglas, the date for the hearings had not been set and the Board had no information as to whether the hearings would be held.

Mr. Szymczak emphasized that, reports to the contrary notwithstanding, the Board had not tried to "kill" legislation at this session, that it was interested in the passage of an effective bill, but that based on the Board's experience over a period of 17 years the Robertson substitute bill was not a satisfactory solution of the problem. He outlined some of the defects of the substitute bill and these were discussed briefly. Mr. Szymczak also suggested that, if the hearings were held, it would be desirable for the Council to have a representative present to present the views of the Council as to what would constitute a satisfactory bill.

Following discussion of the possible reasons for opposition to the bill proposed by the Board, Mr. Vardaman stated that he had conferred with high-level representatives of the Treasury and that they assured him that neither anyone in the office of the Comptroller of the Currency nor the Treasury had anything to do with the preparation of the substitute bill offered by Senator Robertson. Messrs. McCabe and Szymczak stated that it came out during the recent meetings of the Robertson subcommittee that the bill had been drafted in the Office of the Comptroller of the Currency. Mr. Szymczak said that he had been informed by a responsible member of the Office of the Comptroller of the Currency that the draft had been prepared in that office.

Mr. Vardaman stated that he was in disagreement with the position that the Board had taken on the Robertson substitute bill in that he felt that since the Congress had responsibility for drafting legislation and the Board had proposed a bill, it should stand on that bill and should not have undertaken to comment on the Robertson substitute bill.

In the ensuing discussion it was pointed out that the comments of the Board on the Robertson bill had been in response to requests received from Senator Robertson for the Board's views. Reference was also made to the various positions taken by the Treasury Department during the last several years on the form that bank holding company legislation should take.

Chairman McCabe stated that if the suggested hearings were held the Council might wish to take a position on the matter which could be presented to the Senate Committee at that time.

President Brown stated that the Council would consider the matter at its meeting this afternoon.

4. Member bank reserve requirements.

> At the last meeting of the Council a special committee was appointed under the chairmanship of Mr. Fleming to give further consideration to the proposal that reserve requirements of a member bank be based on the character of the bank's deposits rather than on the location of

> the bank. If the report of the committee will be available by the time of the forthcoming meeting, the Board would be glad to discuss it at that time.

> No report of the special committee is available. The committee felt that the first matter requiring consideration under the proposed reserve plan was the problem confronting the livestock banks. At the instance of the committee, members of the Board's staff and representatives of the livestock banks met on May 1 to discuss the reserve proposal. This meeting did not result in any formula or agreement in principle. The committee will continue its study. Members of the committee will be pleased to discuss the matter orally with the Board.

At Mr. Fleming's request, Mr. Beals summarized the discussion at the meeting of representatives of the stock yards banks and the System staff committee on May 1, 1950. Mr. Hemingway commented on a meeting of bankers arranged by the Federal Reserve Bank of St. Louis some two months ago at which Mr. Bopp, Vice President of the Federal Reserve Bank of Philadelphia, discussed the proposed uniform reserve plan. It was apparent from the discussion at that time, he said, that a number of the bankers present were not favorable to the proposal, several having been quite outspoken in their criticism of the plan.

President Brown stated that it was the Council's understanding from the discussion at the previous meeting with the Board that the stock yards banks and their correspondent banks presented a very special problem in relation to the adoption of the proposed plan for computing reserves and that some solution of the problem would have to be found before the plan could be put into effect. The Council felt, he said, that to try to discuss the matter further without finding an answer to that question would result in the stock yards banks campaigning against the proposal which might defeat it entirely. He also said that following a meeting of the board of directors of the Federal Reserve Bank of Chicago, at which the plan was discussed, one of the directors who represented a comparatively small bank voiced his opposition to the plan. President Brown concluded with the comment that Mr. Fleming's committee would continue to study the matter and would discuss it further with the livestock banks through Mr. Beals.

Chairman McCabe stated that the Board would also consider the matter in the light of the report of the System staff committee which had just been received.

5. <u>Purchase of securities directly from the Treasury</u>.

> The Council would appreciate knowing the position of the Board on the proposed legislation (Bill S. 3527) giving the Federal Reserve Banks permanent authority to purchase direct obligations of the Government from the Treasury Department up to a maximum of $5 billion at any one time. On previous occasions the Council has recommended that such authority be limited to a period of three years so the matter could be reviewed periodically by the Congress to determine whether there had been any abuse of the power and whether the

power should be further continued
or be permitted to lapse.

The Council would welcome a statement of the Board's position on this legislation. The Council continues to be unanimously of the opinion that the authority of the Federal Reserve Banks to purchase direct obligations of the Government from the Treasury Department, up to a maximum of $5 billion at any one time, should be continued but limited to a period of not more than three years. The Council feels that the Congress should periodically review the exercise of this power to be sure it has not been abused.

In a discussion of this matter Chairman McCabe read the following paragraph from the report which the Board had made to the Senate and House Banking and Currency Committees in response to requests received from the Committees for comments on the legislation:

"The Board is in agreement with the views expressed by the Treasury Department as to the reasons for which this authority is desirable. Accordingly, the Board favors the enactment of the permanent authority provided in S. 3527. If it should be decided, for reasons of legislative expedition, merely to extend the authority for a period of three years or more, the Board also would not object to enactment of the legislation in that form."

Mr. Vardaman stated that he differed with the position of the Board as stated above for the reason that, while he felt the authority was desirable and should be extended, the extension should not be longer than three years so that it could be reviewed periodically.

Mr. Eccles outlined reasons why in his opinion the authority should be made permanent and why, as long as it was possible for the Federal Reserve Banks to acquire Treasury bills purchased by the Government securities dealers from the Treasury, the limitation contained in Section 14 (b) of the Federal Reserve Act on the authority of the Federal Reserve Banks to purchase directly from the Treasury was not effective.

There was agreement among members of the Board and the Council that, in view of the action taken by the Senate Banking and Currency Committee in recommending an extension of the authority for a period of two years and the position taken by the Board in its reports to the Banking and Currency Committees, in all probability the authority would not be made permanent but would be extended for a further period of two or three years.

6. Financial aid to small business.

> The Board would like to have the views of the Council concerning the proposal with respect to financial aid to small business, including (1) proposed transfer of RFC to the Department of Commerce (2) insurance of loans to small business concerns by the Secretary of Commerce (3) setting up in the Federal Reserve System of proposed capital banks.

With respect to financial aid to small business, --

(1) While the Council believes that the powers and activities of the RFC should be curtailed rather than expanded, it believes that the RFC should be continued as an independent agency to meet emergency situations and should not be transferred to the Department of Commerce.

(2) The Council does not believe that it is either necessary or desirable for the Department of Commerce, or any other agency of the Government, to provide insurance of loans granted to small business concerns. The Council believes that the legitimate borrowing needs of small business are generally met by the banks of the country. In

addition, numerous banks and insurance companies have in the past year inaugurated special departments for making longer term loans to small businesses and have advertised these facilities widely.

(3) The Council is not convinced of the necessity of establishing capital banks of the type proposed in the President's message. Members of the Council have read Senator O'Mahoney's bill as introduced and have seen a late draft embodying various suggested amendments and improvements to it. But they have not seen any Administration bill to carry out the proposals made in the President's message to Congress. Until it can examine definite legislative proposals the Council does not feel that it can express any opinion as to whether such banks if established should be in or outside of the Federal Reserve System.

This topic was not reached until 1:05 p.m. and Chairman McCabe suggested that it be discussed during the luncheon period when he would meet informally with the members of the Council.

7. Next meeting of the Council. President Brown stated that the next meeting of the Council would be held in Washington on October 1-3, 1950.

S. H. Carpenter
Secretary.

Approved:

Thomas B. McCabe
Chairman.