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, October 3, 1950, at 10:45 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Eccles
Mr. Szymczak
Mr. Evans
Mr. Vardaman
Mr. Norton
Mr. Powell

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. DeWitt Ray, President, National City Bank of Dallas, Texas, who attended the meeting in the absence of Mr. Woods, a member of the Council from the Eleventh 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 two subjects to be discussed with the Board. The statement of the topics, the Council's views, and the discussion with respect to each of the subjects were as follows:

1. What further consideration has been given by the Council, or the Special Committee appointed by the Council for the purpose, to the proposal to base reserve requirements of a member bank on the character of the bank's deposits rather than on the location of the bank?

The Council has considered further the proposal to base reserve requirements of a member bank on the character of the bank's deposits rather than on the location of the bank. When the proposal was discussed with the Board in February, 1950, it developed that one of the first matters requiring consideration would be the problem confronting the livestock banks. No formula or agreement in principle has so far been developed for meeting this problem. In addition, under the proposal a considerable percentage of country banks would have been required to maintain higher reserves if total over-all reserves are maintained at the present level. It was apparent that to obtain acceptance of the proposal from the country banks it would be necessary initially at least to reduce over-all reserves. With present inflationary trends, a reduction in over-all reserves would obviously be undesirable.

In view of prevailing unsettled conditions, any proposal for changing the method of determining bank reserves would be disturbing to the banking system at a time when the complete cooperation of the banks is necessary to the efficient functioning of the economy. The method now used to determine reserves is thoroughly familiar to the banks, and the banking system has for many years operated effectively under it. The Council therefore does not favor a change to the uniform reserve proposal at this time.

Before any steps are taken to request authority to increase maximum statutory reserve requirements, the results of the regulation of consumer credit, including more stringent consumer credit regulation, and the results of the regulation of real estate credit should be studied and evaluated. Cooperative voluntary restrictions in the extension of inflationary credit, authorized and intended by the Defense Production Act of 1950 and the President's directive of September 9, 1950, giving control over agreements for such voluntary restrictions to the Board, should be tried with the cooperation of banking and other financial

associations. We recommend that prompt steps be taken by the Board to initiate and stimulate such voluntary agreements.

If economic conditions should thereafter clearly necessitate any change in maximum statutory reserve requirements, the Council is unanimously of the opinion that no special reserve in any class of government securities should be adopted, but that the pattern used in 1948 should be followed, extending temporary authority for increased maximum cash reserves, with the present division for reserve purposes of central reserve, reserve and country banks continued. Any authority granted should be for a period not to exceed two and a half years so Congress would have the right to review the matter.

President Brown reviewed briefly the background for the above statement, commenting that at the meeting arranged by Mr. Beals with representatives of the stockyards banks and members of the System's staff committee on May 1, 1950, it was understood that the staff committee would consider the information presented by the representatives of the banks and submit a further report with respect to the character of the inter-bank deposits of the stockyards banks, but that such a report had not been made. Furthermore, he said, while an increase in the authority of the Board of Governors over reserve requirements might have to be acted upon by the Congress, it was the feeling of the Council that it would be undesirable at the present time to change the basis upon which reserves are computed. He added that a more important action would be the development of voluntary agreements on the part of financial institutions including banks,

insurance companies, and investment bankers as provided in the Defense Production Act of 1950 to which reference was made in the above statement of the Council. He referred briefly to the activities of the American Bankers Association in this field in the past and expressed the view that under the authority of the Defense Production Act much more could be accomplished through voluntary action than had been possible at earlier times.

In response to an inquiry from Chairman McCabe as to whether the members of the Council were of the opinion that uniform reserve requirements were correct in principle but that the present was not the time to propose such a change, President Brown expressed the view that the Council was divided on that point, but that the majority of the Council was opposed to the plan in principle.

Chairman McCabe inquired whether, looking at the problem from a purely objective point of view, the members of the Council would favor the proposal. Mr. Hemingway replied that if it were felt that the Board would use the authority objectively the banks might look at the matter differently and feel that the proposal would be a good thing, but that the reserve city bankers in his area felt that the Federal Reserve System would go to almost any end to get banks to join the System and in so doing would take steps which would injure the business of the correspondent banks.

Chairman McCabe then asked whether the feeling expressed by Mr. Hemingway was generally held and some of the members of the Council said that it was the view of a number of reserve city bankers.

There was a general discussion of the difficulties presented by the proposed plan for uniform reserve requirements including the problem of the stockyards banks and the effect of the plan on country banks. Mr. Fleming, who is Chairman of the special committee appointed by the Council to consider the proposal, stated that following the outbreak of war in Korea he discussed the plan with Mr. Thomas, Economic Adviser to the Board, and that it was agreed that in the existing situation there was no point in the special committee pursuing the matter at this time. For that reason, he said, neither his committee nor the Council had done any further work on the problem.

Chairman McCabe referred to the possibility that the Board might be called upon to present the whole problem of bank reserves to the Congress for consideration and that it would have to be prepared to say whether such a change in the method of computing reserves was desirable at this time. The question, he said, was whether the uniform proposal was sound in principle.

Mr. Fleming responded that even if the problem of the stockyards banks were disposed of, it would be necessary to reduce substantially the total required reserves of member banks in order to get acceptance of the plan by country banks and that that would be undesirable in the present inflationary situation.

Several members of the Council were of the opinion that there was no logic in the present basis for computing reserve requirements and that it should be changed but that the change should not be made at this time.

Mr. Powell called attention to the fact that the formula proposed by the Board's staff was not a fixed formula and could be changed, to which Mr. Fleming replied that in any formula it would be necessary to increase the reserves of country banks in order to maintain anything like the existing volume of total reserves, and even with the formula worked out by the Board's staff, the reserves of something like 15 per cent of the country banks would be increased and that these banks would be very vocal in their opposition to the plan.

Mr. Hemingway suggested that the objectives sought by the Board could be achieved without a change in the law. Mr. Szymczak pointed out why that was not the case.

After some further discussion, President Brown inquired whether the Board had considered any action in connection with the authority of financing institutions to enter into voluntary agreements under the Defense Production Act of 1950. Chairman McCabe suggested that agreements might be undertaken on an experimental basis to which President Brown replied that the arrangement could not be started in one city alone, that it would have to apply to larger loans for which there was considerable competition, and that to meet that situation the

agreements would have to cover financing institutions in New York, Chicago, Philadelphia, Boston, and possibly other cities.

Chairman McCabe suggested that representatives of the banks sit down with representatives of the Board for the purpose of working out a statement that could be submitted to the Federal Trade Commission and the Attorney General. President Brown was of the opinion that the American Bankers Association might get in touch with representatives of banks, insurance companies, and investment banks which were the group that would have to participate in order to make any agreement effective.

Mr. Powell inquired as to the specific objectives of such agreements and there was a general discussion of the areas in which the agreements might operate and of the experience the American Bankers Association had had in this field in the past under limitations imposed by the anti-trust statutes.

Mr. Fleming suggested that the Presidents of the Federal Reserve Banks might be requested to bring in representatives of banks, insurance companies, and investment bankers to serve as a committee to administer the program in the respective Federal Reserve Districts.

President Brown thought that something along the lines of an informal capital issues committee, such as was used in the First World War, might be adopted. He felt that at least at the beginning the agreements should not apply to short-term credits, but rather to

larger loans for longer periods which were made in the form of term loans by banks, direct loans by insurance companies, and security flotations by investment bankers. He suggested that such a committee in each District could pass on loans of, say, $500,000 or more with maturities of more than one year, and that an over-all committee consisting of one representative from each of the twelve Federal Reserve Banks could suggest the types of loans that were inflationary.

There was discussion of how the membership of such committees could be selected and in that connection Mr. Fleming referred to the Banking and Industrial Committees, created in the early thirties to stimulate the granting of credit, the members of which were selected by the Presidents of the Federal Reserve banks.

Following a comment by Chairman McCabe that it was necessary to take prompt action to combat the present strongly inflationary situation and that the important question was what steps would be most effective in that direction, there was a general discussion of the large growth of bank credit during recent months and the character of such growth.

There was also a discussion of the effectiveness of the regulation of consumer credit and real estate credit and Mr. Lochead inquired whether the Board was in a position to indicate the limitations that would be imposed in the regulation of real estate credit.

Messrs. McCabe and Norton outlined the consideration that had been given to the regulation and stated that the Board's study had not yet proceeded to a point where it was possible to state what terms the regulation would prescribe. In response to an inquiry from President Brown as to the extent to which the regulation would undertake to cut back housing starts, Mr. Norton said that the target would be a cut-back to between 800,000 and 900,000 starts next year. He emphasized, however, that the advice given the Board by representatives of the trade was that, because of the large number of existing commitments, the Regulation would have no appreciable effect for five or six months regardless of the terms prescribed.

Mr. Eccles stated that the basic problem confronting the Board and the banks was one of combating inflation, and that this condition probably would exist for some time and could not be corrected in a brief period because of large Government expenditures and the possibility of budget deficits. In that situation, he said, the only effective way to meet the problem was by the adoption of a sound fiscal policy so as to avoid deficit financing to the fullest extent possible. In addition to an adequate fiscal policy, he said, it was also necessary to have a restrictive credit policy to prevent expansion of bank credit from adding to the money supply in relation to the supply of goods and services available, this for the reason that further extension of credit in such a period whether to the Government or otherwise would add to the supply of funds available when that supply was already more

than adequate. He made the further statement that while the Board would do what it could in the direction of regulating consumer and real estate credit, the important thing was effective steps to restrict the over-all supply of credit, that an increase in reserve requirements was an important factor in this picture, that the special reserve plan would be effective in a period of a balanced cash budget, but that it would not be possible to have a tight money policy in a period of deficit or if credit policy were to be subordinated to Treasury financing policy as suggested at the recent convention of the American Bankers Association. Such a step, he said, would be equivalent to saying that there would be no control of the availability of bank reserves or bank credit. He went on to say that the real answer to the present situation was a balanced cash budget accompanied by steps to stop any further growth of bank credit. In a discussion of his statement, he added that while other actions might be called for, such as wage controls and excess profits taxes, the important thing from the standpoint of the System was the adoption of adequate fiscal and credit policies to stop further inflation and that if these steps were not taken the only alternative was a garrison state through direct controls and a regimented economy. He felt that particularly the bankers should recognize that situation and the need for effective monetary action in whatever form was required to accomplish the desired results.

Mr. Bucklin returned to the discussion of the authority of the Board to approve voluntary agreements by financing institutions under

the Defense Production Act and expressed the opinion that this was an important new authority. He thought the banks could do a great deal in this direction that could not have been done previously, that while there were some 14,000 banks the large part of them would be willing to cooperate in carrying out any arrangement that might be worked out, and that such a step might make unnecessary an increase in reserve requirements.

Chairman McCabe suggested that the initiative in connection with such arrangements be taken by the banks. Some of the members of the Council were of the opinion that the initiative should be taken by the Board of Governors. Mr. Congdon offered the view that there were three kinds of credit that needed attention: (1) consumer and real estate credit, (2) loans to produce goods essential for the defense program and which were in short supply, and (3) loans to build inventories. He thought the selective credit regulations of the Board would take care of the first category, that a capital issues committee would be effective in connection with the second group, and that an arrangement for the voluntary restriction of credit would be an effective means of regulating inventory credit.

During a further discussion of the most effective means of getting a statement of an arrangement for voluntary agreements which could be submitted to the Federal Trade Commission and the Attorney General and of the difficulties inherent in the successful operation

of such an arrangement, President Brown suggested that the American Bankers Association might help on the problem and might discuss it with representatives of the insurance companies and investment banks.

Mr. Fleming inquired whether the Board wanted the Council to talk to representatives of the American Bankers Association about the matter.

Chairman McCabe stated that if the Council wished to talk to the American Bankers Association and representatives of the Association wished to discuss it with representatives of the Board, any statement prepared during such discussions could be submitted to the Federal Trade Commission and the Department of Justice for the purpose of ascertaining if it would be satisfactory to them.

Mr. Fleming suggested that the Presidents of the Federal Reserve banks be included in any such discussions.

There was a further discussion of the effectiveness of the terms now prescribed in the Board's Regulation W Consumer Credit, and some of the members of the Council expressed the view that when further action was taken to tighten the Regulation, the change should be such that there would be no tendency to buy consumers goods in anticipation of a further tightening.

2. In accordance with the discussions between Chairman McCabe and President Brown, it is understood that the Council will be prepared to discuss the reduction to two days of the maximum deferment for cash items.

The Council believes in time schedules which are actual and not artificial. Availability should be as prompt as it is possible to make it with the best transportation facilities, but it is an unsound practice to give credit for reserve purposes for an item before it is actually collected. Apart from the fundamental principle that an item should not be credited until it has reached its destination and has been collected, the proposed reduction to two days of the maximum deferment for all cash items would result in more float, and thus in more inflation at a time when efforts are being made to curb inflationary trends. The Council therefore does not favor the proposed reduction to two days of the maximum deferment for all cash items.

Following an explanatory comment by President Brown of the reasons for the above statement, Mr. Powell discussed briefly the reasons for giving member banks the benefit of faster and simpler check collection schedules and for the adoption of two day maximum deferment. Mr. Powell's statement was summarized in a memorandum which he sent to the members of the Board under date of September 29, 1950, a copy of which is in the Board's files. He also called attention to charts showing the extent to which the Federal Reserve Banks at the present time are granting two-day deferred credit.

Some of the members of the Council expressed the view that the action of the System was regarded by many banks as a further step in the direction of immediate credit for all cash items. There were further comments on the desirability of giving credit for cash items before actual collection, the additional float that would be added by the adoption of a maximum deferment of two days, particularly in relation to the additional float created when the maximum was reduced

a number of years ago to three days, and the history of deferred availability and the intention of Congress with respect to collection of checks by the Federal Reserve Banks.

Mr. Fleming commented in this connection that in view of proposals made in the past which struck at the heart of the correspondent banking system, it was to be expected that the banks would resist any further steps which appeared to interfere with their business.

At the conclusion of the discussion Chairman McCabe stated that the Board would take action shortly on the reduction of maximum deferment to two days and that it appreciated very much the consideration given to the matter by the Federal Advisory Council.

President Brown stated that the next meeting of the Council would be held on November 19-21, 1950, and it was understood that the next meeting of the executive committee of the Council with the Board would be subject to call.

Thereupon the meeting adjourned.

S R Carpenter
Secretary.