

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, May 20, 1952, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman  
Mr. Szymczak  
Mr. Evans  
Mr. Powell  
Mr. Mills  
Mr. Robertson

Mr. Carpenter, Secretary  
Mr. Sherman, Assistant Secretary

Messrs. Bucklin, Smith, Gund, Fleming, Davis, Brown, Alexander, Ringland, Beals, Ray, and Lohead, Members of the Federal Advisory Council from the First, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively.

Mr. Henry C. Alexander, President of J. P. Morgan & Co., New York, New York, who attended the meeting as alternate for Mr. N. Baxter Jackson from the Second Federal Reserve District.

Mr. Prochnow, Secretary of the Federal Advisory Council.

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

1. What are the business and economic prospects over the next six months? What suggestions does the Council have with respect to system credit policies during that period?

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Although economic conditions at present are reasonably stable, there is distinctly less optimism now among business men and bankers regarding the business outlook for the next six months than prevailed earlier this year. Employment, personal income, and activity in many lines continue at a high level, but there are weak spots in important industries, such as those engaged in manufacturing household appliances, house furnishings, textiles, shoes and in meat packing. Inventories of most commodities and materials are in ample supply, and shortages have been largely eliminated. Assuming no important change in the international situation and no serious interruption of steel production, the Council does not expect either a severe decline or a sharp upward trend in business during the next few months. The majority of the Council think a slight recession in business activity is more probable than an upturn. The volume of bank loans has been declining. Considering the country as a whole, it appears at present, that apart from normal seasonal swings, the volume of bank loans will decline slightly in the balance of the year.

Unless conditions change materially, the Council favors a continuance of the current rediscount rate and of open market operations which will make the rediscount rate effective and thus provide a reasonably firm money market and an orderly and flexible market for government securities. The Council approves the action taken relative to the suspension of the Voluntary Credit Restraint program and of Regulation W, in view of the decline in loans which had occurred and evidence of deflationary tendencies. If inflationary forces again become clearly evident, and assuming the Defense Production Act is extended by Congress, the Council recommends that the Voluntary Credit Restraint program be reactivated. During the period it was in effect it was an important influence in restraining unnecessary credit.

President Brown stated that the Federal Advisory Council was slightly more pessimistic as to the economic outlook for the next six months than Mr. Thomas, Economic Adviser to the Board, appeared to be in his review of the situation presented to the Council yesterday

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afternoon. None of the members of the Council, President Brown said, expected any serious recession, much less anything resembling a depression, but they felt the total volume of business was likely to decline somewhat and that total employment would decrease slightly. The members of the Council felt that this would be healthy for the country as a whole since it would result in some leveling off of inventories and would permit adjustments which might take some of the pressure out of demands for wage increases which were resulting in higher costs.

As to the actions which the Federal Reserve System should take, President Brown said that the Council would recommend a continuation of the existing credit policies, and felt that open market operations had been extremely effective and had been conducted with great skill in the last six months. He also said that the removal of state and municipal issues from the Voluntary Credit Restraint Program took the heart out of it at a time when loans generally were declining and the suspension of the program was wise.

He added that immediately following suspension, however, interest was shown by many potential borrowers in obtaining credit which previously they had not applied for because they felt that it would not have been granted while the program was in effect. President Brown went on to say that the Council felt that if inflationary tendencies should become



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clearly evident again on more than a temporary basis, it would be preferable to reactivate the program rather than to try other more radical changes such as a change in reserve requirements or a higher discount rate.

In response to a question from Chairman Martin as to the judgment of the Council concerning the possible reinstatement of Regulation W, Consumer Credit, if there were a renewal of inflationary pressures, President Brown said that he would put the Voluntary Credit Restraint Program into active operation first. With respect to Regulation W, he stated that it was obvious that virtually every listed article was or shortly would be in surplus supply excepting possibly certain of the more popular makes of automobiles.

Mr. Fleming agreed with the views expressed by President Brown both as to the Voluntary Credit Restraint Program and as to the supply situation for articles which had been listed under Regulation W. He also inquired as to the possibility of continuing the collection of loan figures from selected banks which had been assembled under the Voluntary Credit Restraint Program, and Governor Powell replied that this matter was now being studied and that if the banks were willing to report the figures he felt they would be collected. Mr. Fleming stated that he felt the continuation of the loan figures was important to the banks and he hoped the Federal Reserve would continue to assemble the data

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which he was sure most banks would be willing to report.

Mr. Bucklin entered the meeting at this point.

Governor Powell stated that one of the problems under the Voluntary Credit Restraint Program had been the handling of loans by banks to finance companies and that the Committee had taken the stand that the program need not be applied to such loans on the ground that they were restricted at the stage of consumer use of the credit under Regulation W. He asked for the views of Council members as to whether, if inflationary pressures were renewed, it might be practicable to bring finance company loans within the scope of the Voluntary Credit Restraint Program in the absence of Regulation W.

This question was discussed but no strong opinion was expressed as to how effective the Voluntary Credit Restraint Program might be if applied to loans to finance companies. Mr. Davis said that the finance companies might regulate the ultimate terms of credit themselves reasonably well, and Mr. Ringland felt that the problem lay with the retailers who extended the credit and then turned to the finance companies to discount their receivables. Mr. Ringland expressed the view, however, that an attempt might be made to restrict such credit under the Voluntary Credit Restraint Program if it were reactivated.

In response to a question from Mr. Fleming as to the probable extension of the Defense Production Act, Chairman Martin stated that he

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had been asked to appear before the House Banking and Currency Committee tomorrow morning to testify and that while the Senate had passed a bill extending the Act, he was unable, at this stage, to guess what action the House might take. He stated that it would be helpful to have the views of the members of the Council as to the need for extending the Defense Production Act, particularly the question of continuing authority for the Voluntary Credit Restraint Program and the consumer credit and real estate regulations, all of which would expire on June 30, 1952 unless extended.

Several individual members of the Council expressed their views, all of those who spoke indicating that they felt authority for the Voluntary Credit Restraint Program and the consumer credit regulation should be continued. Some of them felt that authority for the real estate credit regulation also should be continued although President Brown stated that he was less certain that such authority was needed and that he was even more doubtful that continuation of authority for price or wage controls was needed.

Chairman Martin then asked for a further discussion of the business outlook and at President Brown's suggestion several of the members of the Council commented on conditions in their districts, most of them indicating that bankers and businessmen generally felt some recession in business was under way. However, none of them felt that a sharp decline was to be expected.

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2. What effect is Regulation X having in the economy at the present time and what, if any, action should the Board take with respect to liberalization or suspension of the Regulation?

Under present conditions, Regulation X no longer serves any useful purpose as regards non government guaranteed real estate credit. The regulation has not had a marked effect on the financing of lower-priced houses. It does result in hampering the construction and sale of higher-priced houses, and causes much needless irritation and injustice. The Council is unanimous in recommending that the regulation now be suspended.

President Brown stated that he was surprised at the unanimous view of the members of the Council that Regulation X, Real Estate Credit, should be suspended. He said that after discussing the matter fully the Council felt that it would be desirable for the Board to suspend the regulation entirely at this time rather than to relax it insofar as non-government insured or guaranteed credits were concerned. This feeling was based upon the fact that the regulation was not needed under present conditions insofar as non-government guaranteed real estate credit was concerned and that the regulation was difficult to administer and caused unnecessary hardship in a good many cases.

Chairman Martin asked whether the members of the Council would also be unanimous in recommending suspension of Regulation X if, as a practical matter, such action would result in re-emergence of no-down-payment loans guaranteed by the Veterans Administration and more extensive use of the very liberal provisions of the Federal Housing Act.



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President Brown said he could not guess what the Housing and Home Finance Administrator would do in the absence of the restrictions against non-government guaranteed credit but that if he understood the situation correctly, it would be possible to continue restrictions in connection with extensions of Veterans Administration and Federal Housing Administration guaranteed or insured credits. He added that he still felt Regulation X should be suspended and that if the Veterans Administration was going to run the risk of guaranteeing mortgages with no down payment, that was their concern.

Mr. Lohead stated that there was considerable complaint in the Pacific Coast area against the practice of permitting contractors to sell Veterans Administration guaranteed mortgages at discounts of as much as 2 or 3 per cent in order to place the loans which were not acceptable to private lenders at the existing 4 per cent rate.

Governor Evans stated he had not heard of such complaints on a national scale although it was recognized that there was difficulty in placing many of the Veterans Administration guaranteed mortgages at the present 4 per cent rate.

Several members of the Council then commented upon the real estate situation in their respective districts, some of them indicating that a number of unsold completed houses were being carried by builders in both



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lower- and higher-price brackets while others stated that shortages of houses, particularly in lower- and medium-price brackets, continued in their areas.

3. The Board would appreciate any comments that the Council might wish to make relating to the Bank Holding Company legislation discussed in Chairman Martin's recent letter to Congressman Spence, Chairman of the House Banking and Currency Committee. (Letter dated April 11, 1952.)

The Council, as constituted from time to time in the past, has repeatedly expressed itself in favor of bank holding company legislation. In a letter to the Board of Governors on February 20, 1950, the Council approved bank holding company bill, S. 2318, then before the Committee on Banking and Currency of the Senate, with certain amendments which the Council understood were acceptable to the then Board. This bill had met the general approval of the bank holding companies with one important exception. No action was taken on S. 2318 by the Committee on Banking and Currency of the Senate, to which it had been referred, and the bill died with the 81st Congress.

In view of the widespread operations of the various bank holding companies in different parts of the United States, the Council believes that a bank holding company bill should be initially drafted by the Board of Governors and the provisions of the draft fully discussed by the Board with the principal holding companies and others affected, before the Board urges the passage of any bank holding company legislation.

The Council believes that the proposed bases for legislation stated in Chairman Martin's recent letter to Congressman Spence should be discussed with the various bank holding companies and with bankers' associations. Pending their being embodied in the draft of a bill and so discussed, and opportunity given to consider their effect, the Council does not feel it can express an intelligent opinion about them.

President Brown stated that it was impossible to discuss bank holding company legislation intelligently on the basis of general principles, and that he and several other members of the Advisory Council had

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given a great deal of time in the past few years to the study of such legislation and had discovered many new problems whenever any specific proposal for legislation was made. He noted that the Council had taken a position in favor of S. 2318, as indicated in its letter to the Board on February 20, 1950, with certain amendments, but the bill had died with the 81st Congress. As to the general principles stated in Chairman Martin's letter of April 11, 1952 to Congressman Spence, President Brown felt that while they might be generally acceptable it was not possible to know just how specific situations would be affected until specific legislation was drafted. He stated that he did not feel that the test of ownership proposed in Chairman Martin's letter was satisfactory but at the same time the Council would not wish to have the Board feel that it was trying to evade the question presented by the Board, and that it was simply a matter of being unable to comment specifically on Chairman Martin's letter without having a draft of an actual bill.

Mr. Lohead discussed the situation on the Pacific Coast and Mr. Ringland commented briefly on bank holding companies in the Ninth Federal Reserve District.

At Chairman Martin's suggestion Governor Robertson made a statement as to the background for Chairman Martin's letter of April 11 to Congressman Spence. Governor Robertson said that there were just two

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problems with which the supervisory agencies needed to be concerned, one of these being unrestricted bank holding company expansion and the other being the control of nonbanking activities by bank holding company groups. These, he felt, would both be dealt with adequately by legislation along the lines suggested in Chairman Martin's letter. Governor Robertson emphasized that the Board had not expressed a view as to the agency which should administer bank holding company legislation for the reason that it felt the Congress should decide where the responsibility should be placed. Also, the Board did not feel it would be appropriate to propose legislation until a committee of Congress asked for its suggestions. He reiterated that legislation carrying out the general principles stated in Chairman Martin's letter to Congressman Spence would be a significant step, that it was essential to have support of all Federal bank supervisory agencies for any legislation that was to be enacted, and that it appeared that proposals along these lines might result in at least an absence of opposition on the part of any of the three Federal bank supervisory agencies.

Mr. Lohead expressed doubt as to the adequacy of legislation limited to the points Governor Robertson discussed, and there followed a general discussion at the close of which President Brown expressed the Council's great interest in holding company legislation and its desire to study and comment on any specific proposals for dealing with the problem.



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4. The Board will also be glad to consider with the Council any questions which the members of the Council might have with respect to the study of the check collection system being undertaken under the auspices of the Federal Reserve System with the cooperation of the American and Reserve City Bankers Associations.

The members of the Council are pleased that a comprehensive and exhaustive study of the check collection system is being undertaken under the auspices of the Federal Reserve System and with the cooperation of the American and Reserve City Bankers Associations. The Council is also glad to note that the Federal Reserve System is not suggesting the study for the purpose of encroaching upon or weakening the correspondent bank relationships of the commercial banks, but solely for the purpose of reducing expenses and increasing efficiency. It is important that any proposals growing out of the study be thoroughly analyzed and fully discussed if they are to meet with the general approval of the banks, without which there is little chance for their adoption. As the committee makes preliminary reports, the Council will welcome the opportunity to discuss them with the Board.

President Brown stated that the Council realized that the present check collection system resulted in multiple expenses through duplicate listing of items and delays in collection. The Council felt that the committee which had been formed was an excellent one both on the part of the Federal Reserve and on the part of the American Bankers Association and the Association of Reserve City Bankers. There was nothing more, he said, that he could add at this time.

At Chairman Martin's suggestion Governor Mills reported on the current status of the work of the committee, noting that the project was suggested by the Conference of Presidents of the Federal Reserve Banks

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but that it was essentially a joint project of the American Bankers Association, the Association of Reserve City Bankers, and the Federal Reserve System, attempting to reach a common objective of simplifying and expediting the procedures for collection of checks. A skeleton program had been developed at a meeting in New York last week, Governor Mills said, and within the next few days it was expected that suggestions of the interested groups would be received, making it possible to get the work under way at an early date. Governor Mills emphasized that the work of the committee had as its objective the improvement of the check collection system and in no sense was it interested in attempting to draw more check collection business to the Federal Reserve System away from the correspondent banks.

In response to a question from Mr. V. J. Alexander, Governor Mills stated that it had not yet been finally determined whether the industrial engineer to be employed by the committee would serve purely as a consultant or whether he would also serve as member of the committee. Mr. Alexander felt that such a consultant should have no vote in committee decisions since he would not be a representative of the banking fraternity.

Mr. Lohead withdrew from the meeting during the foregoing discussion and Governor Evans withdrew at this point.

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5. What legislative or other actions might be taken to improve the capital positions of banks and encourage increases in bank capital including actions that might be suggested by the study of excess profits taxes of commercial banks? For example, what should be the attitude toward the issuance of preferred stock or capital debentures by member banks as a means of raising new capital?

In connection with the Excess Profits Tax, the Council recommends that the Board strongly support favorable legislative action on the proposal of the special committee on excess profits tax of the American Bankers Association. In brief, this proposal provides that a bank be entitled to treat as borrowed capital six and two-thirds per cent of its deposits, other than United States Government and domestic inter-bank deposits. The proposed formula would lessen the present injustice to banks which are not allowed to include any portion of their principal indebtedness, that is, their deposits, in computing their invested capital base. Other corporations are allowed a high percentage of their total indebtedness if they use the invested capital base. Except for the smaller banks, almost all banks find it necessary to use the invested capital method. The proposed change would not only enable banks to make highly desirable additions to their capital out of retained earnings, but would make it easier for them to sell additional common stock.

All members of the Council are agreed that action on the Excess Profits Tax is the immediate and pressing need, if the banks are to meet the problem of increasing their capital. If favorable action is taken on the Excess Profits Tax, the question of the issuance of preferred stock or capital debentures tends to become less important. Particularly if there is no relief on taxes, it may be necessary for the banking supervisory agencies to change their attitude on the approval of the issuance of preferred stock or capital debentures by banks.

President Brown referred to the above-mentioned proposal of the American Bankers Association with respect to a change in the law regarding the application of the excess profits tax to banks which representatives



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of the Association recently discussed with Chairman Martin and other members of the Board. He stated that the proposal had been arrived at after careful study and that it was understood there was a real chance that it might be adopted by the Congress before the end of June. While the amount of excess profits tax incurred by the banks on 1951 earnings was relatively small and would not make a very great addition to capital funds if used entirely for that purpose, President Brown felt that a great proportion of the banks would be in the excess profits bracket in 1952. He said that both as a matter of equity and as assistance to the banks in adding to their capital funds, the Council hoped the Board would support the proposal of the American Bankers Association committee if the Board believed there was any real possibility of the legislation being considered at this session of Congress.

Mr. Fleming commented that while he originally had not felt there would be much chance of passage of the proposed legislation at this session of Congress he had come to feel that there was a real possibility it would be considered and that favorable action might be taken.

At Governor Powell's request there were distributed to the members of the Council copies of two memoranda prepared in the Board's offices dated May 5, 1952, and May 15, 1952, with respect to the excess profits tax study conducted by the Board and the probable effects of such

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taxes on the ability of banks to add to their capital funds. He pointed out that if all of the excess profits tax incurred on 1951 earnings were added to capital funds of the banks of the country they would be increased by only 2/100 of 1 per cent of total assets or by 2/10 of 1 per cent of their capital accounts at the year-end. Governor Powell also said that it did not appear to him that this would do what was primarily needed in the way of increasing bank capital and that while the Board had taken no position on the matter, he personally questioned whether it would be desirable to go "all-out" in favor of a proposal to change the tax laws affecting banks when it might be found later that some other form of action would be necessary.

Chairman Martin said that while, as indicated by Governor Powell, the Board had not taken a position on this matter, he felt it only fair to say that in his judgment there was a serious question whether the Board should undertake a proposal which it might not be prepared to support on an "all-out" basis. He added that in his opinion there was little likelihood of Congress taking any action on the matter at the present session and that, regardless of that point, while he appreciated the comments of the Council with respect to both the need for capital funds and the equity of a change in the excess profits tax as applied to banks, he was somewhat skeptical whether it would be desirable for the Board to support the resolution proposed by the American Bankers Association.

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There was a brief discussion of the desirability of encouraging the issuance of preferred stock or capital debentures by banks needing additional capital, during which Mr. Fleming said those were emergency measures and their use might cause the public to lose some of its confidence in the soundness of banks. In closing, Mr. Fleming expressed the hope that if the Board found it could not support the proposal of the American Bankers Association at this session of Congress, it would be willing to have a further study made of the effect of the excess profits tax on banks, particularly with respect to 1952 earnings.

6. Do the members of the Council have any comments on or suggestions with respect to the Patman hearings?

The members of the Council commend the Chairman and members of the Board and the Presidents of the Federal Reserve Banks for the able manner in which they prepared and presented the answers to the questions submitted to them by the Patman Subcommittee, and on their testimony before it. The Council hopes that these answers and the hearings generally will promote a more intelligent and widespread understanding of the functions, duties, and problems of the Federal Reserve System. The Council will be pleased to discuss the final report of the Patman Subcommittee if the Board desires to do so after the report is released.

President Brown stated that Mr. Smith had reported a conversation with Mr. Williams, President of the Federal Reserve Bank of Philadelphia, who had suggested that it might be desirable for the Board to summarize the results of the Patman hearings and distribute them in advance of the



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issuance of the report of the subcommittee. President Brown went on to say that in the opinion of the Council an excellent job had been done by and on behalf of the Board in answering the questionnaire and in the testimony presented by Chairman Martin, Governor Powell, Messrs. Sproul and Bryan, Presidents of the Federal Reserve Banks of New York and Atlanta, and others connected with the System. He stated that the Council felt the position of the Federal Reserve System was much stronger than before the hearings even though at the outset of the inquiry the purpose might have been to weaken the System. It seemed clear to the Council, he said, that there was not much to be done in connection with the inquiry until the report was issued and that it could not now be foretold what the nature of that report would be. President Brown added, however, that when the report was released and the Council had an opportunity to study it, it would like to have a further discussion of the matter with the Board. He also said that he and all of the other members of the Federal Advisory Council were strongly opposed to the formation, by legislative enactment, of a committee composed of the heads of several Government agencies to advise on credit policies, on the grounds that such a committee would be only a means of putting pressure on the Board.

Chairman Martin said that the Board concurred heartily in President Brown's suggestion for a continued discussion of the Patman hearings,

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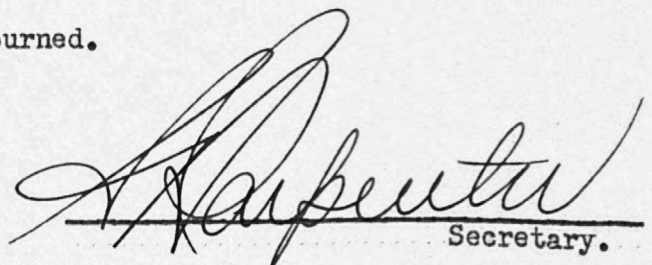
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that in his opinion this was just one of a series of hearings of this sort that would be held over the next few years, and that he felt it important to assess the results of this particular hearing so as to have the benefit of all suggestions that might be made as to the course that should be followed by the System. Chairman Martin referred to the suggestion by Mr. Smith for a summary of the results of the hearing, commenting that the Board had in mind the preparation of a pamphlet or booklet based upon the material collected but that it felt it would not be possible or desirable to issue such a booklet before the committee report was available.

Chairman Martin stated that he and the other members of the Board appreciated the fine work that had been done by President Brown and Vice President Fleming of the Council in connection with the Patman hearings, as well as by Mr. Prochnow, who had served as one of the consultants to the Board in the preparation of answers to the questionnaire submitted to the Board by the Patman Subcommittee.

In a discussion of the date for the next meeting of the Federal Advisory Council it was agreed that the meeting would be held on October 5, 6, and 7, 1952, rather than at the regularly scheduled time, September 14-16.

Thereupon the meeting adjourned.

  
Secretary.