

Minutes of the Board of Governors of the Federal Reserve System
on Thursday, May 11, 1961. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Balderston, Vice Chairman
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. King

Mr. Kenyon, Assistant Secretary
Miss Carmichael, Assistant Secretary
Mr. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Noyes, Director, Division of Research
and Statistics
Mr. Farrell, Director, Division of Bank
Operations
Mr. Solomon, Director, Division of
Examinations
Mr. Harris, Coordinator, Office of Defense
Planning
Mr. Holland, Adviser, Division of Research
and Statistics
Mr. Furth, Adviser, Division of International
Finance
Mr. Potter, Legal Assistant

Letter from Commission on Civil Rights. As the result of certain suggestions that had been made, the staff was now preparing a revised draft of reply to Staff Director-designate Berl I. Bernhard of the Commission on Civil Rights transmitting answers to certain questions raised in his letter of April 24, 1961, regarding policies and practices of member banks in the field of mortgage lending.

Governor Balderston reported that a follow-up letter had been received from Mr. Bernhard inquiring as to the availability of the

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Board's reply, and that he had tried unsuccessfully to reach Mr. Bernhard by telephone to advise him that the reply would be sent within a few days.

After discussion, it was agreed that no interim reply seemed necessary unless there should be some unexpected delay in responding to Mr. Bernhard's original letter.

Inquiry from President Hayes. A letter from the Federal Reserve Bank of New York dated May 2, 1961, regarding maximum permissible rates on time and savings deposits under Regulation Q, Payment of Interest on Deposits, had been distributed to the members of the Board.

Governor Balderston stated that in a telephone conversation President Hayes had inquired whether the Board would have any objection to his sending copies of the letter to the other Reserve Bank Presidents for their information.

No objection was expressed, and it was understood that Governor Balderston would so advise President Hayes.

Membership dues and contributions of Federal Reserve Banks (Item No. 1). A draft of letter to the Presidents of all Federal Reserve Banks with reference to membership dues and contributions had been circulated to the members of the Board. In reviewing budget performance records for 1960, it had been noted that some payments budgeted in prior years as membership dues or contributions had now been reclassified to other expense categories. The letter would express the view that such payments should be included in the supplementary budget statements of

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membership dues and contributions in order to avoid any possible interpretation that an effort was being made to cover up such expenditures. The letter, therefore, would request the Reserve Banks to include all membership dues and contributions in the supplementary statements when preparing their 1962 budgets.

Mr. Farrell, in commenting on the proposed letter, stated that one Reserve Bank, after some deliberation, had decided that payments to the National Industrial Conference Board and to the Urban Land Institute should be regarded as de facto subscriptions to the publications of these organizations. Also, the Bank considered disbursements to policemen, firemen, and postal clerks associations to be payments for services rendered. After checking, it was learned that other Reserve Banks might be following this same line of reasoning. Accordingly, the proposed letter had been drafted.

Mr. Fauver brought out that in cases where expenditures of this type had been listed under contributions and membership dues in previous years, their reclassification, even if justifiable, might be misinterpreted. Therefore, it would seem desirable for the Reserve Banks to continue itemizing all contributions and membership dues in the supplementary budgets statements so that there could be no question in this regard.

Mr. Molony commented that there might be considerable merit to the view that payments to organizations such as the National Industrial

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Conference Board could properly be classified as subscriptions when such payments were necessary to obtain valuable publications. However, he agreed that as an internal matter for the information of the Board, it seemed advisable for such expenditures to be itemized under membership dues and contributions.

After further comments along these lines, Governor Shepardson recalled the discussion of membership dues and contributions at the joint meeting of the Board of Governors and the Presidents of the Reserve Banks on September 13, 1960. At that time it had been suggested that the Presidents' Conference undertake to prepare a statement on the justification for payment of various classes of membership dues and contributions by the Reserve Banks, particularly membership dues in organizations such as State bankers associations. Governor Shepardson inquired as to the status of that statement, and as to any possible conflict with the proposed letter to the Reserve Banks.

Staff comments made in response were to the effect that there would not appear to be any particular difficulty, from the standpoint of the suggested statement, in sending the proposed letter to the Reserve Banks. As to the status of the statement, it was indicated that the Secretary's Office would check into the matter with the Chairman of the Presidents' Conference.

After further discussion, the letter to the Reserve Banks was approved unanimously. A copy is attached as Item No. 1.

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Report on S. 1771 (Item No. 2). There had been distributed, with a covering memorandum from the Legal Division dated May 8, 1961, a draft of letter to Chairman Robertson of the Senate Banking and Currency Committee replying to a request for the Board's views on S. 1771, a bill "To improve the usefulness of national bank branches in foreign countries." S. 1771 would amend section 25 of the Federal Reserve Act to permit the Board of Governors of the Federal Reserve System by regulation, subject to certain statutory restrictions, to authorize foreign branches of national banks to exercise, in addition to powers which they may exercise under other provisions of law, "such further powers as may be usual" in connection with the business of banking in the places where such branches transact business. The proposed reply would state that the Board recommended passage of S. 1771.

After discussion, the letter was approved unanimously. A copy is attached as Item No. 2.

Mr. Potter withdrew from the meeting at this point.

Guidelines for emergency monetary policy (Item No. 3). With a memorandum from Mr. Harris dated May 3, 1961, there had been distributed to the members of the Board a proposed revision of the Guidelines for Emergency Monetary Policy (Annex IV to the Board's Emergency Plan). The memorandum indicated that the guidelines had been developed by an ad hoc System committee, reviewed during Operation Alert 1960, revised thereafter, and referred to the Presidents' Conference Committee on Emergency

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Operations for comment. Certain suggestions were offered on March 7, 1961, by the Conference of Presidents. It was recommended in the memorandum that the Board approve the proposed revision of the guidelines, which incorporated all except one of the suggestions of the Presidents' Conference.

In commenting on the proposed revision, Mr. Harris observed that the guidelines were intended to cover a post-attack period when the Board might be cut off from communication with the Reserve Banks. In this manner, a basis would be established for reasonably consistent actions in the interval before communication could be re-established. The principal emphasis in an immediate post-attack period would be to provide liquidity for financing essential activities, keeping in mind that sooner or later excess liquidity might be built up and that it would become necessary to take restrictive steps.

In further comments, Mr. Harris stated reasons why the revised guidelines did not reflect one of the suggestions of the Presidents' Conference, which involved a reference to repurchase agreements. He also referred to two suggestions by members of the Board's staff and stated how it was proposed to handle them, in one instance by a minor change in the draft.

After discussion, the Board approved unanimously the revised Guidelines for Emergency Monetary Policy, with the understanding that

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copies would be distributed to appropriate parties at the Board and the Federal Reserve Banks. A copy of the document is attached as Item No. 3.

Mr. Hexter, Assistant General Counsel, entered the room at this point and Mr. Harris withdrew.

H.R. 6900. At the suggestion of Governor Mills, there was a preliminary discussion regarding H.R. 6900, introduced in the House of Representatives on May 9 by Congressman Multer. This bill would eliminate the requirement that Federal Reserve Banks maintain certain reserves in gold certificates against deposit and note liabilities (now 25 per cent) and would permit domestic banks to pay interest on time deposits of foreign governments at rates differing from those applicable to domestic depositors.

Governor Balderston observed that Chairman Martin would return over the week end and there would be an opportunity on Monday, May 15, for a full discussion of the bill. It was expected, he said, that Chairman Martin would testify on the bill Thursday, May 18, and the staff had been requested to begin preparation of appropriate material.

Noting that enactment of the bill would make a fundamental change in the Federal Reserve Act, Governor Mills commented that it would seem appropriate for the Board to have the views of the Reserve Banks and the Federal Advisory Council regarding the bill.

Governor Balderston expressed apprehension concerning the effect of extended Congressional debate on the bill. He also noted that a

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reduction of the gold reserve requirement from 40 to 25 per cent had been accomplished during the war period and at that time there was no extensive public discussion or apparent loss of confidence in the dollar, possibly because the minds of the people were on other things.

Replying to a question from Governor Mills, Governor Balderston stated that, whereas he felt some months ago that the gold reserve requirements represented a useful symbol of restraint, he now believed the most important factor was for the United States to muster its full resources so that, if called upon, it could do whatever was necessary to maintain world confidence in the dollar.

Governor Mills then raised the question whether the present provisions of the law did not provide an inherent discipline, and whether their abrogation would not contradict the purpose of the original legislation and separate the Federal Reserve System from a valuable statutory safeguard against overexpansion of credit. He also raised the question whether it would not seem preferable to retain the present safeguard and suspend it temporarily, if necessary, in an emergency.

Governor Mills went on to say that he had not sensed for years such widespread concern about developments in the financial area of Federal administration. The Federal Reserve System, he noted, was properly regarded as a bulwark standing for the maintenance of established principles of fiscal and monetary policy. As noted by at least one participant in a recent meeting of the Federal Open Market Committee, there

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seemed to be an undercurrent of concern about the drift of financial developments, with the implication that these developments would eventually produce another period of inflation. The effect of the proposed elimination of the gold reserve requirements would be to deliver the United States completely over to the theory of managed money, with no safeguards other than the judgment and principles of those managing the monetary affairs of the nation.

Governor Balderston expressed the view that prudence in the handling of monetary affairs was essentially the final safeguard, as demonstrated by the lack of effectiveness of statutory requirements in countries where such prudence was not exercised. He then asked Mr. Furth to comment on the practices followed in leading countries.

Mr. Furth responded to the effect that in practically all of the major European countries it was the current practice to rely on prudent monetary management rather than statutory requirements. Thus, it was up to the monetary authorities to insure that the international solvency of the country was safeguarded.

Governor Robertson said that he was not prepared at this time to express a view as to what the Board's position on the bill should be. It would be necessary, however, to arrive at a position before the Chairman testified on May 18. This suggested that it would be desirable to wire the Reserve Bank Presidents today, giving them appropriate information on the scope of the bill and requesting them to advise the Board of their views.

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Governor Balderston noted that the Federal Advisory Council would be meeting with the Board on Tuesday, May 16, and it would be possible to request the views of the Council members at that time.

In response to a question, Mr. Hexter stated that a draft of possible statement that might be used by the Chairman was being prepared for distribution to the members of the Board tomorrow.

In this connection, Governor Balderston pointed out that the Board had already reported on a bill that would exempt time deposits of foreign governments from interest ceiling provisions. He assumed that the Board would not wish to change its position in that regard.

Governor King commented that he sometimes longed for many of the disciplines that were imposed by the gold standard which was a system of money backed by more than men's minds. However, he was aware of the position of the United States in the world today, and he believed the essential question was whether any real purpose was served by the gold reserve requirements now contained in the Federal Reserve Act. He had tried to find some useful purpose in these provisions, but could find very little. True, they might serve to require facing up to a problem sooner than would otherwise be the case. However, the Congress had moved directly from a 40 to a 25 per cent gold reserve requirement several years ago, and it would seem that a 10 per cent requirement could be justified almost as easily as 25 per cent. Essentially, therefore, he was not convinced that the present requirement imposed any real restraint that would make the

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Federal Reserve System more responsible than it would otherwise be. Accordingly, since the requirement was to him a symbol that offered no great strength, he could see no real purpose in opposing the proposed legislation. While he was not sure that this was the right time for such legislation, he did believe it was a better time than several months ago.

At the conclusion of further general discussion involving various aspects of the bill and its implications, it was understood that a telegram would be sent to the Reserve Bank Presidents today asking for their views on H.R. 6900, and that copies of the bill and a statement made by Congressman Multer when introducing the bill also would be sent to the Banks for their information. It was also understood that a draft of statement for use by Chairman Martin in testifying on the bill would be distributed to the Board tomorrow with a view to further discussion at the meeting on Monday, May 15.

The meeting then adjourned.

Secretary's Note: Governor Shepardson today approved on behalf of the Board the following items:

Memorandum from the Division of Research and Statistics dated May 5, 1961, recommending acceptance of the resignation of Eva J. Mason, Statistical Clerk in that Division, effective at the close of business May 26, 1961.

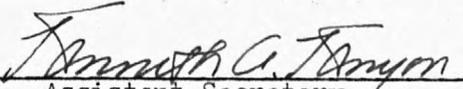
Memorandum from the Division of Examinations dated May 10, 1961, recommending that Andrew W. Lee be appointed as Consultant in that Division on a temporary contractual basis for a period not to exceed 90 days from the date on which he begins his services, with compensation

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at a rate of \$35 per day for each day worked for the Board, either in Washington, D. C., or outside the city, plus actual transportation expenses in accordance with the Board's travel regulations and a per diem in lieu of subsistence of \$12 for all time in travel status in connection with his duties as Consultant. It was understood that for purposes of travel, Mr. Lee's headquarters would be Washington, D. C.

Memorandum from the Division of Personnel Administration dated May 11, 1961, recommending that the Board adopt for its employees the policy set forth in Civil Service Commission Mobilization Circular No. 33. This circular, which applies to Government departments and agencies in the Executive Branch in the event of an attack on the United States, provides that in time of a national emergency the 1951 limitation placed on payments for excess annual leave will be set aside and cash payments for such leave will be authorized, and that a policy of granting annual leave to the maximum extent possible consistent with the emergency be followed in order to keep the amount of excess annual leave accumulations to a minimum. It was understood that the Commission interpreted Circular No. 33 to include payment for excess leave in case of resignation.


Assistant Secretary

Item No. 1
5/11/61

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

S-1791

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 11, 1961

Dear Sir:

As you know, Reserve Bank budget items for membership dues and contributions have been of particular concern to the Board in recent years. The interest and cooperation of the Reserve Bank presidents and their boards of directors in reviewing these expenditures have been most helpful. Considerable progress has been made in minimizing the potentiality for criticism in this sensitive area.

In reviewing budget performance records for 1960, however, a new trend has been noted that might undermine some of the good already accomplished. Some payments that were budgeted in prior years under membership dues or contributions have now been reclassified in other expense categories. For example, in 1960 one Reserve Bank reclassified its payments to the following organizations and eliminated them from the supplementary statement of membership dues and contributions.

National Industrial Conference Board
Urban Land Institute
Policemen, firemen, and postal clerks associations

The Bank advised that after some deliberation the payments to the NICB and the Urban Land Institute were considered to be de facto subscriptions to the publications of these organizations. It considered disbursements to the policemen, firemen, and postal clerks associations to be payments for services rendered.

There is considerable merit to the view that payments to organizations such as the NICB do not fit exactly the definition of membership dues inasmuch as they do enable a Reserve Bank to receive certain publications not otherwise available. Nonetheless, the Board feels that payments of this type should be included in the supplementary statement of membership dues and contributions to avoid any possible interpretation of an effort to cover up such expenditures.

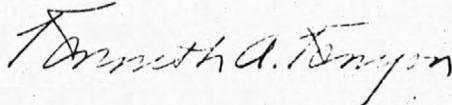
Similarly, the Board recognizes that there may be local situations where contributions to groups or associations of public service employees might be considered "payments for services rendered." Previous reviews of



such payments, however, have indicated that these services would be performed without such contributions and, in fact, most Reserve Banks do not make them. Where such payments are made, it is important that they be shown as a contribution and included in the supplementary budget statement.

It may well be that there are other instances of a similar nature that have not come to the Board's attention. Once payments are deleted from the supplementary statement, it is difficult to trace specific items. It would be appreciated, therefore, if in preparing their 1962 budgets the Reserve Banks would include all membership dues and contributions in the supplementary statements. The Board will be glad to discuss any questions concerning items about which there may be some doubt as to whether they should be included.

Very truly yours,



Kenneth A. Kenyon,
Assistant Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

Item No. 2
5/11/61

OFFICE OF THE VICE CHAIRMAN

May 12, 1961



The Honorable A. Willis Robertson,
Chairman, Banking and Currency Committee,
United States Senate,
Washington 25, D. C.

Dear Mr. Chairman:

This is in response to your request of May 4, 1961,
for a report on bill S. 1771, now pending before your Committee.

S. 1771 would amend section 25 of the Federal Reserve Act to permit the Board of Governors of the Federal Reserve System by regulations to authorize foreign branches of national banks to exercise, in addition to powers which they may exercise under other provisions of law, "such further powers as may be usual" in connection with the business of banking in the places where such branches transact business. The exercise of such additional powers would be subject to such conditions as the Board's regulations might prescribe, and the regulations could not authorize a foreign branch to engage in a general business in goods, wares, or merchandise, nor in the business of underwriting, selling, or distributing securities.

S. 1771 is virtually identical to section 44(f) of Title II of S. 1451 (85th Congress), the "Financial Institutions Act of 1957", which passed the Senate on March 21, 1957. In recommending such an amendment in 1956, the Board of Governors expressed the opinion that it would reduce the obstacles to effective competition by national banks abroad. (Legislative Recommendations of the Federal Supervisory Agencies to the Senate Committee on Banking and Currency, October 12, 1956 (Committee Print, 84th Cong., 2d Sess.), pp. 111-112.)

The Board of Governors continues of the opinion that such legislation is desirable "for the furtherance of the foreign commerce of the United States", the express purpose for which national banks were originally authorized to establish branches abroad. (12 U.S.C. 601.) Accordingly, the Board of Governors recommends the passage of S. 1771.

Sincerely yours,

(Signed) C. C. Balderston

C. Canby Balderston,
Vice Chairman.

Rev. May 15, 1961.

Item No. 3
5/11/61

GUIDELINES FOR
EMERGENCY MONETARY POLICY

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Introduction

In the event of a nuclear attack on the United States, many of the offices of the Federal Reserve System would be destroyed. It is expected, however, that some offices would survive. These offices would have to assume responsibility for the conduct of System affairs in their areas until such time as System organization could be re-established. The purpose of these Guidelines is to provide such suggestions and instructions as can be made in advance of such an emergency.

The impossibility of foreseeing all circumstances, and the certainty that conditions would differ widely throughout the country, emphasize the importance of providing Reserve Banks with maximum flexibility in the application of all instruments of monetary policy. It should be recognized, however, that until the System could re-establish internal communication, these Guidelines could furnish the basis for reasonably consistent actions in the interval before communication is re-established. These Guidelines, therefore, are intended for use to the extent that they seem appropriate only in the interval immediately following an attack and until an operational, discretionary System organization is re-established.

The Federal Reserve System's primary objective in the immediate postattack period would be to provide liquidity for financing essential activities and to provide confidence in the

continued operation of the monetary and banking system. In providing necessary liquidity it is possible that sooner or later excess reserves may be built up in some areas. Steps must be taken to curb or absorb such excesses when, in the judgment of the Reserve Banks, the excesses are putting undesirable pressures on the qualitative controls set forth in Treasury's Emergency Banking Regulation.

The Reserve Banks should give every encouragement to surviving commercial banks to remain open or to reopen as promptly as feasible. Preattack announcements should emphasize that credit for essential purposes would be extended liberally through the discount window in an emergency, and that penalties on deficient reserves would be waived until further notice.

Since it is expected that rediscounting would be the principal means by which Federal Reserve credit would be extended, the legal instruments for making such credit extensions under emergency conditions should be prepositioned.

Discount Administration

1. Reserve Banks should implement the Board's Emergency Regulation No. 1 as soon as practicable following an attack.

2. Reserve Banks should advance funds freely to banks in need of liquidity, both member and nonmember, in order to promote essential activity. Reserve Banks should satisfy themselves to the extent practicable that the use of funds by the borrowing banks does not involve any willful violation of Treasury's Emergency Banking Regulation.

3. Considerations of formality of contract, security, and maturity of advances should be regarded as secondary to the problem of meeting the obvious essential needs of banks operating in conformance with Treasury's Emergency Banking Regulation. Arrangements of the type authorized by the Board's Emergency Regulation No. 1, which include a line of credit, should be used to the extent possible. It would be desirable for the Reserve Bank to establish with banks, pre-emergency, the general terms (other than amount) upon which the Reserve Bank would grant credit in the event of an emergency.

4. Reserve Banks may make advances to nonbank customers, when credit is not available elsewhere, on reasonable terms and when funds are needed for an essential purpose.

Discussion

The first and foremost objective of discount administration in an emergency is to assure, insofar as possible, that no pockets

of credit unavailability develop because of an illiquid position on the part of banks which might hinder the conduct of essential industrial, business and service activities. A second objective is to maintain as orderly an operation of the discount function as is practicable under postattack conditions.

In furtherance of the first objective, it would seem appropriate to open the discount window to nonmember banks. This could be particularly important because the areas of least damage probably would be in rural areas in which nonmember banks are more numerous. It may be that in the postattack environment there still will remain some reasonable grounds for distinguishing in the degree of accommodation offered member and nonmember banks. However, it is deemed prudent to provide authority under the Board's Emergency Regulation No. 1 for the full gamut of lending services to nonmember as well as to member banks. Measures to control reserves thus created are covered in the section on "Reserve Requirements."

In furtherance of the second objective, it would seem appropriate to leave to Reserve Banks full discretion as to which discount and loan procedures, contracts and terms are most appropriate in the circumstances then existing.

Provision for advances to nonbank customers is designed to take care of cases of obvious need and obvious essentiality in circumstances where, for one reason or another, commercial bank credit is not available at reasonable terms. Such loans should be of the "last resort" type and should be kept to a minimum.

Discount Rate

1. Credit extended by Reserve Banks to banks in the immediate postattack period should carry the same discount rate that prevailed preattack.
2. Credit extended to nonbank customers should be at rates deemed appropriate under the circumstances by Reserve Banks.

Discussion

Administration of the discount function would be far more important than the rate charged. Discount rate policy would have relatively little significance in the immediate postattack period. For such significance as it would have, however, it would seem quite inappropriate to raise rates in the immediate postattack period since this might give a false impression of tightness without serving any useful purpose. Also, it probably would not be desirable to lower the rate at a time when it would be impossible to foresee the pattern of rates which might emerge. Accordingly, the initial postattack discount rate for credit extensions to banks should be the same as the last preattack discount rate.

Purchases and Sales of Government Securities

1. Reserve Banks have been authorized to make direct purchases and sales of Government securities on their own account in an emergency when out of communication with the Federal Open Market Committee.

2. Purchases should be made only when, in the judgment of the Reserve Bank, such action is necessary, after taking into account and placing primary reliance on discounts and advances, to provide necessary credit, liquidity and confidence.

3. Purchases, when appropriate, may be made from both bank and nonbank customers at prices slightly below those on comparable maturities of securities just prior to the attack.

4. Sales may be made when, in the judgment of the Reserve Bank, such action is deemed necessary to absorb excess liquidity or to reverse earlier postattack purchases.

5. Purchases and sales, both outright and under repurchase agreements, should be made in accordance with the techniques and procedures set forth in Federal Open Market Committee--Guides for Emergency Operations (Annex III). Sales of Treasury's special certificates of indebtedness should be made in accordance with Treasury's memorandum, December 10, 1956, (Schedule G, item 7).

Discussion

The Federal Open Market Committee, by resolution, March 6, 1956, authorized Reserve Banks to make purchases, under certain emergency conditions, after taking into account the possibility of providing necessary credit through advances. (See Annex III) The Board

has authorized Reserve Banks to make needed credit freely available to banks by other means including discounts and advances on secured or unsecured promissory notes. (See Board's Emergency Regulation No. 1, and section on Discount Administration, herein.)

These Guidelines do not limit the broad authority placed with Reserve Banks by the Federal Open Market Committee's resolution, March 6, 1956, to make purchases when necessary to meet a variety of unforeseen circumstances. Rather, they provide a general rule that in the exercise of such authority Reserve Banks should provide necessary credit, liquidity and confidence through discount administration and advances before resorting to direct purchases.

It is assumed that a two-way market would not develop immediately following an attack; therefore, direct purchases, when appropriate under these circumstances, should be regarded as isolated transactions, prices should be slightly below those prevailing immediately prior to the attack, but may be varied if local circumstances warrant, and no commitment should be made as to a postattack yield curve. Reserve Banks are furnished, on a continuing basis, with current data on prices and yields of various maturities of Government securities by the Federal Reserve Bank of New York.

Sales of securities to commercial banks provide a means for absorbing excess reserves and liquidity. Other means and conditions conducive to sales are described in the section on Problems of Excess Liquidity, herein.

Reserve Requirements

1. Immediately following an attack, legal reserve requirement ratios would be at the level prevailing immediately before the attack. Reserve Banks should include in their emergency instructions to commercial banks a statement that in case of emergency the Reserve Banks would have authority to waive penalties on deficient reserves if considered desirable.

2. Authority to raise or to lower reserve requirements has been delegated to Reserve Banks until such time as the Board would be in a position to resume such authority. Reserve Banks may exercise this authority without regard for provisions of existing statutes and regulations; i.e., minimum and maximum limitations may be ignored, and requirements may be varied according to regions or types of banks in the light of changes in reserve balances.

3. The average dollar amount of required reserves of a commercial bank in the last reserve period prior to an emergency should be used as the reserve base until such time as it becomes possible to compute the requirement on the basis of currently reported deposit liabilities.

4. Member bank reserve requirements may be extended to nonmember banks when conditions warrant.

Discussion

This treatment of reserve requirements has been designed to provide maximum flexibility to the operations of commercial banks and Reserve Banks during a period when communications might be impaired.

At the same time, the reserve requirement is preserved for use during a subsequent period.

The authority to lower or to raise reserve requirements should be used vigorously and boldly, even in the short run, if circumstances within a particular district indicate that some action on reserves is necessary.

The desirability of extending reserve requirements to non-member banks grows out of the probability that foreseeable circumstances could develop which, in the absence of such extension, would seriously impair reserve operations. The foreseeable circumstances include the probability of substantial transfers of credit and deposit accounts (authorized by Treasury's Emergency Banking Regulation No. 1) from inoperable to operable banks, resulting in the probability of substantial shifts of deposits from member banks to nonmember banks, the impairment of effective reserve operations, and the need to extend reserve requirements to all banks in a uniform manner as soon as conditions warrant. Transitional measures may be adopted when, in the judgment of the Reserve Bank, such measures are desirable to facilitate such extension.

Selective Credit Controls

1. Reserve Banks should not impose selective credit controls in the immediate postattack period though such action might become desirable at a later date.

2. Reserve Banks should enforce the selective aspects of Treasury's Emergency Banking Regulation by assuring themselves, to the extent possible, that liquidity furnished to the commercial banks by the System is being used in consonance with that Regulation.

3. Reserve Banks should supply no liquidity by rediscount or other means to commercial banks known to be violating willfully Treasury's Emergency Banking Regulation.

Discussion

This guideline is couched in negative terms to emphasize that the application of selective credit controls such as Regulations W and X would be considered inappropriate during the immediate postattack period.

Problems of Excess Liquidity

1. In the event a Reserve Bank detects the emergence of excess liquidity in the banking system, it should introduce measures to curb and absorb such excess liquidity. The emergence of excess liquidity might appear as a local, rather than a general problem. Excess liquidity should be assumed whenever a commercial bank, having made all the loans and investments that seem consonant with the Treasury's Emergency Banking Regulation, then uses excess reserves to extend credit not in consonance with this Regulation.

2. The role of Reserve Banks in this regard would be, first, to give guidance to commercial banks in determining what was and was not consistent with Treasury's Regulation. Second, where excess liquidity by this definition did develop, measures to curb and absorb such excess liquidity might include:

- (a) Increases in reserve requirements;
- (b) Accelerated repayment of advances; and
- (c) Sale of Government securities.

3. The Reserve Banks will take account of the degree of liquidity of the nonbank public, including the level of bank deposits, in determining appropriate levels of bank liquidity.

4. If excess liquidity emerges only in specific regions of the district or in specific types of commercial banks, or if the volume of excess liquidity varies substantially within the district, the Reserve Bank should vary the application of measures to curb and absorb excess liquidity accordingly.

Discussion

This guidance is provided in recognition of the possibility that excess liquidity may develop, and may require some action in the period during which these Guidelines are intended to apply. Perhaps the major problem will be the definition of "excess." It will not be sufficient to apply the term to any funds that seem to be standing idle. There are always idle funds to be found, even in periods when businessmen are trying diligently to keep working balances at a minimum. The emergency will close off many normal channels of external finance and of easy transfer of funds between firms and between regions, and this may force the maintenance of higher working balances. The attack will destroy some of the real assets standing behind large quantities of financial assets, thus forcing many persons to hold larger than normal quantities of money relative to their spending needs. Also, the liquidity needs of commercial banks will be increased by their having to provide a larger portion of total financing until other financial markets can be restored, and by their having to take account of unpredictable movements of funds and deposits in unaccustomed patterns.

In the immediate postattack period, the role of the Reserve Banks will be chiefly to give commercial banks guidance in the interpretation of the Treasury's Emergency Banking Regulation and to encourage the easy availability of funds to all legitimate sectors of the economy. Very soon after the attack, however, the Reserve Banks will face the possibility of excess liquidity, and by and large they will have to meet it in an ad hoc manner.

Problems of excess liquidity will be minimized if the qualitative restrictions on bank lending contained in Treasury's Emergency Banking Regulation are rigorously adhered to. Such restrictions, by limiting a bank's lending opportunities, would have the automatic effect of influencing a bank to invest excess funds in Treasury paper. This result would coincide with an undoubtedly large need for funds on the part of the Government.

In summary, the primary objective of the System would remain that of providing liquidity and assurance to the financial community and to others attempting to carry out essential activities. Once that objective has been achieved, it would be necessary to establish control of reserve funds created in the process. Since the timing and the extent of the need for restrictive actions cannot be foreseen, these Guidelines suggest measures which may be taken if, in the judgment of the management of a Reserve Bank, action is required.