The attached minutes of the meeting of the Board of Governors with the Federal Advisory Council on November 17, 1964, which you have previously initialed, have been amended at the request of Governor Daane to revise his comments appearing in the first and third double-spaced paragraphs on page 28.

If you approve the minutes as amended, please initial below:

Governor Daane	
Chairman Martin	
Governor Robertson	R
Governor Balderston	CCB
Governor Shepardson	
Governor Mitchell	

Minutes for November 17, 1964.

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date. 1/

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin

Gov. Mills

Gov. Robertson

Gov. Balderston CCB

Gov. Shepardson

Gov. Mitchell

Gov. Daane

1/ Meeting with the Federal Advisory Council.

Minutes of a meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council that was held in the Board Room of the Federal Reserve Building in Washington, D. C., at 10:30 a.m. on Tuesday, November 17, 1964.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Mills
Mr. Robertson
Mr. Daane

Mr. Sherman, Secretary
Mr. Bakke, Assistant Secretary

Messrs. Martin, Day, Stoner, Watlington, McRae, Smith, Hickok, Moorhead,[1] Breidenthal, Aston,[2] and Cook, 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. George A. Murphy, Chairman, Irving Trust Company, New York, New York

Mr. Prochnow, Secretary, Federal Advisory Council
Mr. Korsvik, Assistant Secretary, Federal Advisory Council

In the absence of Mr. Moore, Member of the Council from the Second Federal Reserve District, Mr. Murphy represented that District at this meeting.

Before this meeting there had been distributed a memorandum from the Federal Advisory Council setting forth the topics suggested by the Board for consideration at this meeting and the views of the Council concerning them. The topics, the statement of the Council with respect to each, and the substance of the discussion were as follows:

1/ President of the Council.
2/ Vice President of the Council.

1. Economic conditions and prospects.

A. What is the general outlook for the U.S. economy over the next six months?

The members of the Council believe that the general outlook for the U.S. economy for the next six months is favorable. Although the expansion has continued for 45 months and gives little evidence of tiring, there are some factors of the economy, such as housing, which are not expanding. Presently, the areas of strength continue to outweigh the weaknesses.

B. What are the views of the Council with respect to the probable impact on the economy of the second stage Federal tax reduction to take place in 1965?

It is unlikely that the second stage of the reduction in Federal taxes to take place in 1965 will have a very marked impact on economic activity. The take-home pay of the nation's wage earners has already been adjusted to the reduced rate. Furthermore, it is generally expected that the taxes withheld from salaries this year will be insufficient to cover accrued tax liabilities. As a result, a considerable number of persons may be obliged to make additional tax payments in April. Finally, the aggregate reduction in taxes on individual incomes in 1965 will be less than that which went into effect last March.

The reduction in taxes on corporate profits, however, should help maintain the rising pattern of after-tax corporate earnings.

C. Have there been significant changes with respect to plant utilization and/or production bottlenecks since the September meeting of the Council, or are there indications of developing problems in these areas?

Although there are some reports of problems in these areas, the members of the Council are not aware of significant changes with respect to plant utilization and/or production bottlenecks since the September meeting of the Council. One problem that has developed recently is the shortage of employable labor in certain communities. The rising trend in capital investment is tending to lengthen the delivery time of machine tool manufacturers. The automobile strikes have reduced somewhat the demand for steel and the resulting pressure on the mills which appeared to be an area where delivery difficulties might develop.

In opening the discussion of this topic, Chairman Martin inquired about the outlook for commercial construction.

Mr. Murphy responded that in New York City the surge of building commenced in 1963 in anticipation of new and more restrictive zoning regulations had largely been completed, but plans for new construction and actual starts appeared to be continuing apace. The high level of demand for loans to finance commercial building that had existed in recent years showed no signs of diminishing. Occupancy ratios, even in older buildings,were good, and the apparently inexorable trend of growth from within on the part of business tenants was a large factor in keeping available space filled and in creating new demand for office quarters.

At President Moorhead's suggestion, Mr. Murphy also commented on probable effects of construction of the proposed World Trade Center in New York City. While immediate availability of the office space planned for this facility would cause distress to the older commercial buildings in the city, its promoters planned to phase the office quarters into service gradually. In sum, therefore, Mr. Murphy was of the opinion that the impact of the Center on occupancy in other commercial buildings would not be acute.

Mr. Day observed that, nationwide, there was some indication of a slowdown in rate of business investment, based on a projection by

McGraw-Hill Company of a 5 per cent expansion in commercial building starts during 1965, compared with 14 per cent in 1964.

In response to a question from Chairman Martin, Mr. Day said that he had no reason to question the accuracy of this survey, although he personally felt that the expansion in 1965 was more likely to be around 7 or 8 per cent than 5 per cent.

Mr. Smith commented that no significant retrenchment of commercial building appeared to be in prospect in the Seventh Federal Reserve District.

Chairman Martin then solicited views of the Council regarding prospective demand for automobiles.

Mr. Smith stated that he had made a number of inquiries in his District following recent publication of statements to the effect that there was evidence of reduced interest in General Motors products. As a result, he had reached the conclusion that such was not the case; this was re-enforced by statements of the company's officials that a good year of sales and profits was anticipated, albeit not as dramatic as the 1964 performance.

Mr. Martin observed that approximately 400,000 units of production had been lost by the strike and, while the impact was difficult to predict, the inventory situation at the dealer level in the First District appeared to be satisfactory.

Mr. Murphy added that because of a trend toward earlier scrapping of automobiles, the net addition to cars on the road had not increased greatly during the last five years or so. Furthermore, because of the considerable demand for new automobiles engendered by the increasing number of 2-car families, new marriages, and similar factors, the supply of automobiles did not appear excessive in terms of anticipated consumer needs.

Concerning the economic impact of the second stage Federal tax reduction in 1965, President Moorhead observed that the Council was in general agreement that its anticipated benefits had largely been discounted already, although some improvement in posted corporate earnings should result.

Mr. Day suggested that the scheduled tax reductions were an almost essential component of measures needed to keep the economy growing at the predicted rate for 1965.

Governor Daane inquired as to the effect that removal of approximately $1 billion in excise taxes, as recently proposed by the President, might have on the tone of the economy.

Mr. Day felt the impact of such action would be beneficial to the nation's economic viability, and Mr. Murphy expressed the view that, while repeal of the excise taxes involved might be a "plus" factor in the economy, its significance in the market place would not be as great as would a further reduction in income taxes, since the consumer does not perceive the direct impact of the former as clearly as he does the latter.

Governor Robertson stated that he had been surprised to hear recently from the Board's staff that this year's reduction in withholding from wages (from 18 per cent to 14 per cent) might not result in as great a shortage in withholdings of individuals to meet tax liability for the 1964 tax year as had been expected, partly because there seemed to have been considerable added voluntary withholdings.

Governor Balderston said that he was generally in accord with the optimistic tone of thinking about the economic effects tax reductions could be expected to have on business prospects during the early part of 1965. However, he cautioned that these anticipated benefits could be seriously compromised by an inflationary wage settlement or prolonged strike in the steel industry.

2. Banking developments.

A. What is the Council's judgment as to business demands for bank financing during the latter part of 1964 and the first half of 1965?

The members of the Council anticipate that business demands for bank financing during the latter part of 1964 and the first half of 1965 will be somewhat stronger than seasonal. Corporate cash flows may be reduced by the acceleration in tax payments and by some narrowing of profit margins. As a consequence of such developments, together with a probable acceleration in inventory accumulation, the members of the Council anticipate a strengthening in business demands for bank financing.

B. Is there evidence of increasing use of bank credit to finance precautionary inventory accumulation? Of term loans to finance plant expansion?

The members of the Council have so far seen little or no evidence of an increased use of bank credit to finance precautionary inventory accumulation. While there is a good demand for term loans, there has been no strong upward push to finance plant expansion.

C. Have the members of the Council noted any changes of more than seasonal proportions in the demand and time balances maintained by their larger corporate customers since midyear?

Demand deposits have increased slightly more than seasonal in recent months, but it is not conclusive that the trend will persist. Furthermore, total time deposits of corporations have also apparently increased more than seasonally. However, some members of the Council report reduced totals of time deposits and no significant gain in demand deposits.

D. The Board would appreciate the current views of the Council as to prospects for issuance of short-term capital notes to secure loanable funds.

The Council anticipates an expansion in the issuance of short-term notes to secure loanable funds, particularly if interest rates rise above ceilings imposed on time deposits. The growing and continued use of this technique probably will be confined for the present to the larger banks in the major money centers.

President Moorhead stated that while business demand for bank financing through the first half of 1965 might be somewhat stronger than could be attributed to seasonal needs alone, the picture differed from one Reserve District to another. Thus, in the Ninth District the outlook was for a lessening of demand as compared with the current year.

Mr. Cook anticipated a reduced demand for business loans in the Twelfth District during the first half of 1965; banks were responding to this prospect by investing more extensively in municipal obligations. In response to a question from Chairman Martin regarding a recent paucity of corporate securities issues, Mr. Cook said that he could not explain this development. However, he had observed that the fall-off was taking place in industry groups other than public utilities, which continued to be aggressive seekers of public capital.

Mr. Watlington suggested that one possible explanation for the phenomenon referred to by Chairman Martin was the fact that many private placements with institutional investors were taking place with the result that the issues did not find their way into the stream of public trading, thus giving the impression of reduced corporate offerings.

Governor Daane requested elaboration on the Council's prediction of a probable acceleration in inventory accumulation during the latter part of 1964 and the first half of 1965.

President Moorhead attributed this view largely to the uncertainty surrounding the outcome of wage negotiations in the steel industry, the recent rise in price of basic metals, and similar factors leading to a moderate apprehension of inflationary developments.

Mr. Martin added that a factor of immediate significance at the retail level was the anticipation of heavy consumer demands during the Christmas season.

Mr. Aston commented that part of the increased demand for bank loans to finance inventory accumulation reflected a relaxation of banks' attitudes toward term loans. In the Southwest an increase in warehouse loans had been noted, prompted not only by attractive rates but by the fact that such financing was, by and large, easier and quicker than other forms of borrowing. As an example of the attractive features of term lending by banks, he cited the recent borrowing of

$40 million by Allegheny Corporation for 7 years at 4-1/2 per cent, with no amortization of principal called for during the first five years. He felt that the attractive terms available on term business loans probably reflected competitive pressures engendered by a developing trend on the part of banks in most Federal Reserve Districts to seek business across District lines.

President Moorhead concurred with Mr. Aston's last comment, observing that there was an increased tendency for banks to be aggressive for business wherever it could be found.

Chairman Martin observed that formerly not many customers were able to negotiate for loans at the prime bank rate. He wondered whether it would be fair to say that, because of increased competition, the prime rate was being tendered to a wider range of borrowers.

Mr. Day felt this to be the case. He also noted a nationwide softness of mortgage demands, and because of the pressure on banks to get lendable funds out into sound commitments there was a noticeable move of mortgage rates toward the prime rate level as well.

President Moorhead remarked that competition for mortgage business was fierce.

On the question of precautionary business inventories, Mr. Martin stated that some increased accumulation might be expected, since the business community had become used to prosperity and was optimistically looking forward to continued expansion.

President Moorhead noted that some increase in inventory accumulation could also be expected because of a general anticipation that prices would continue to push upward. A number of Ninth District firms planned to raise prices on their products in the near future, and if this thinking was generally shared throughout industry, the inevitable consequence would be a move toward increased inventories of products at present price levels as a hedge against such increases.

Chairman Martin commented that he had discussed the inventory question with a group of purchasing agents not long ago; although they expressed pessimism with regard to price stability, they had not felt much change in inventory levels was in prospect. Since this point of view was somewhat at odds with the foregoing comments, he inquired whether there might have been a recent shift of the economy into a new phase.

Responses that followed generally supported this thesis. Mr. Aston stated, however, that he found little evidence of precautionary inventory accumulation in the Eleventh District, attributable in large measure to steps by large producers to computerize inventory control procedures, thereby leading to more efficient operations and cost savings greater than could be realized by stockpiling components and materials.

Mr. Murphy observed that inventories generally tended to move in cycles in response to the outlook for raw material prices. The situation naturally would vary in particular instances, but a build-up in inventories could be expected as a hedge against price increases where indicators pointed in that direction, whereas purchasing agents tended to balance inventories against immediate needs more closely in times of price plateaus. Because of the recent wage settlement in the automobile industry and the projection of results of the negotiations now in progress in the steel industry, the outlook seemed to be for rising prices. The announcement by automobile manufacturers of their intention to hold the line on prices may have tended to mitigate somewhat public apprehension of inflationary results from the wage settlement in that industry. However, this optimism might not be well-founded, since there were many ways in which automobile prices could be increased indirectly, such as by omitting from the basic price certain accessories now included. By contrast, the steel industry's prospective settlement would almost certainly be reflected directly in higher steel prices since steel fabrications are by nature an irreducible unit.

Mr. Smith concurred in the prediction of higher prices and consequent defensive inventory accumulations, pointing out that manufacturers generally were building up their steel stocks on the premise that there was nothing to lose by buying now.

Mr. McRae commented that in at least one shipyard with which he was familiar there was hesitancy to accept large contracts because of delays in obtaining delivery of steel plate. If this situation was widespread the impact of increased steel prices should not result in a general upward spiral of prices.

Mr. Cook added that new fabricating processes being developed by the steel industry should contribute to significant savings in the cost of production, which, in turn, might even lead to a reduction in the price of some steel items.

Turning to the situation regarding corporate demand and time deposits, Mr. Day observed that Third District banks were still aggressively soliciting certificate of deposit business in order to keep up with the heavy demand for loans. There seemed to be a growing trend for corporate money to move away from financial institutions in the smaller cities to those in New York and Chicago.

Governor Mills inquired whether banks seemed to be ranging beyond their own Federal Reserve District in the quest for certificate of deposit business.

Mr. Day responded in the affirmative, noting that because of commitments on lines of credit or loans to large accounts it was necessary to seek time deposits wherever they could be found. A further contributing factor, he said, was the fact that the largest banks were going after business all over the country, and therefore to maintain a competitive posture the banks of lesser size also had to find deposit money wherever they could.

In response to another question from Governor Mills, Mr. Murphy stated that, by and large, banks tended to feel a greater allegiance to domestic borrowers than to those abroad, since the former category of customer was the one to which the banks largely looked for their deposit balances. When the supply of loanable funds became tight, foreign lending seemed to be the first area in which restraint appeared, largely because banks felt it imperative to service domestic customers to the fullest extent possible in order to retain their accounts.

President Moorhead and Mr. Watlington also commented that bank service areas generally were tending to become more wide-spread geographically.

Governor Mills inquired whether banks were beginning to rethink their credit policies in view of the fact that purchasers of a bank's certificates of deposit or instruments of direct borrowing who were geographically remote from the bank were generally inclined to feel less loyalty to the institution than the bank's local customers.

President Moorhead said that such appeared to be the case, and Mr. Murphy commented that the heavy reliance being placed on certificates of deposit as a source of loanable funds was presenting a difficult situation for many banks. This was particularly true for smaller banks, because the interest rate now offered was at the maximum allowed by the Board's Regulation Q, and banks were having difficulty attracting new time deposit money to replace maturing certificates of deposit. When the prevailing rate on time deposits was below the Regulation Q ceiling corporate treasurers were inclined to shop around for the most attractive rate, but with virtually all banks now offering the maximum interest there was little incentive on the part of these individuals to be selective. Borrowing from abroad was an avenue of salvation for a bank finding itself in an awkward position of liquidity, and while such borrowing was usually uneconomical because the interest rates paid on such funds were generally higher than the return banks were realizing on their portfolio investments, recourse to this source of funds did allow a certain degree of flexibility in smoothing out fluctuations in liquidity and in perfection of the scheduling of time deposit maturities.

President Moorhead observed that the upward trend in corporate demand deposit balances was difficult to explain, although a possible explanation might be an increase in float due to use of computer calculations to judge the balance required at a given bank to cover outstanding checks.

Governor Balderston inquired whether there was evidence of a slowdown in turnover of demand deposits, to which Mr. Watlington responded that, to the contrary, all evidence pointed to even more aggressive use of demand balances now as compared with last year.

Regarding the use of short-term negotiable notes to secure loanable funds, President Moorhead commented that so far only a few banks had resorted to this device, although virtually all of the major institutions regarded the issuance of such instruments as a prospective necessity if adequate certificate of deposit business could not be maintained.

Governor Daane asked about maturities borne by the notes that had been issued to date, and President Moorhead replied that while the controlling factor was the desire of the purchasers, the usual duration was in the range of 90 days to 6 months.

Mr. Murphy added that investors today tended to look for short-term commitments, and these notes, which were generally viewed as the equivalent of certificates of deposit, were considered to be a device for circumventing the 1 per cent ceiling set by Regulation Q for short-term money. Most banks were sorry to see the use of these notes evolving, but such a development was regarded as necessary to avoid the strictures of Regulation Q. He added that in New York, due to certain provisions of the penal code that appeared to preclude banks from issuing such instuments, the practice had not developed yet. The State Attorney General had the matter under advisement, however, and present thinking was that if he rendered an opinion holding them illegal the legislature would repeal the statutory provision involved in order to avoid having New York banks suffer a competitive disadvantage.

Mr. Murphy also voiced the thought that short-term capital notes might well develop favor among bankers to the virtual exclusion of certificates of deposit, because funds generated by the notes carry no reserve requirements and do not figure into the calculation of required payments to the Federal Deposit Insurance Corporation. He also foresaw the possibility that maturities would be tailored to virtually any length desired by purchasers, even as short as 2 days. While acknowledging the foregoing comments to be purely personal speculation, he pointed out that no one had expected certificate of deposit business to develop to the proportions it had reached, and the same phenomenon might well occur with respect to the note device.

President Moorhead expressed the opinion that while broader use of notes might develop, they could never be expected to supplant certificates of deposit as a source of loanable funds because of the statutory limitations applicable to borrowing by banks.

Mr. Martin concurred in this view, adding that supervisory authorities might welcome the trend toward use of these notes because of the inherent control mechanism involved in the statutory limitation on allowable indebtedness. He pointed out that national banks generally tended to follow the Board's view of what constitutes capital for purposes of calculating the extent of borrowing permissible, rather than the more liberal interpretation of the Comptroller of the Currency. This fact, he felt, was one more point in support of the conclusion that capital note issues were not likely to supplant certificate of deposit transactions to any extreme degree.

Chairman Martin inquired whether it would be reasonable to rely on the prudence of banks generally to keep the issuance of such notes within reasonable bounds, and Mr. Martin responded affirmatively, stating that the traditional reluctance of banks to have borrowings shown in their financial statements would be an added restraint on excessive resort to this source of funds.

Mr. Murphy did not foresee a substantial increase in corporate demand deposits, but capital notes of banks presented an attractive vehicle for use by corporate treasurers to invest funds at maturities consistent with their needs.

Governor Mills observed that corporate treasurers had traditionally followed closely the debt position of the banks with which they dealt, and he inquired whether there was evidence of a relaxation in this attitude to the point that a bank's level of borrowing would not be a factor in corporate decisions regarding purchase of its short-term notes.

Mr. Murphy expressed the opinion that corporate treasurers would continue their cautious scrutiny of the debt position of a bank before purchasing its notes, and if the bank was overextended the treasurer would no doubt turn elsewhere to invest his firm's money. Mr. Murphy then reiterated the thought that the basic stimulus to the development of traffic in banks' short-term notes was the continuing search that was going on in the banking community for means of circumventing Regulation Q, in order to attract funds with which to satisfy loan demands. This posed the question whether this situation should be allowed to continue or whether it would be preferable to change Regulation Q.

Governor Mills observed that if the present interest rate ceilings under Regulation Q were to be removed, banks might find it difficult to place their loans with the soundest accounts unless the prime rate were to move upward as well.

Mr. Murphy acknowledged this to be the case but pointed out that by allowing higher interest rates under Regulation Q a situation akin to that now prevailing with respect to the availability of foreign capital would be created, in that banks could make forward loan commitments with confidence feeling assured that the necessary funds could be procured even if premium rates had to be paid.

Mr. Aston interjected the opinion that the developing use of short-term notes was not merely a stratagem to circumvent Regulation Q; rather, it was an essential means of staying competitive in the money market vis-a-vis the commercial paper firms, which are not under regulatory restraints as are the banks with which they compete.

Chairman Martin stated his understanding that, from the tenor of the preceding discussion, it was the consensus of the Council that rather than an increase in the Regulation Q interest rates, banks should be allowed to continue seeking their own solutions to the problem of attracting new loanable funds.

Mr. Aston stated that this was his view, commenting that in his opinion an amendment to Regulation Q would be of marginal utility.

Governor Balderston inquired whether thought had been given to the effect of allowing interest to be paid on demand deposits--might this moderate the present difficulties banks were having in competing for funds in the money market?

Mr. Watlington replied that this idea had not been discussed, because of the statutory prohibition against such a practice.

President Moorhead observed that, while payment of interest on demand deposits was prohibited by law, where banks issue notes with a 1- or 2-day maturity the distinction between this practice and the payment of interest on demand deposits was a fine line indeed.

Mr. Cook added that the services available to customers of a bank, regardless of the nature of his account, could well be equated to payment of interest, thereby supporting an argument that demand deposits are already bearing interest, albeit indirectly.

In this connection, Mr. Watlington noted that banks were faced with a genuine problem in holding down a proliferation of services, since there was a strong temptation to offer more and more to customers in response to competitive pressures.

3. Are there any changes in banking legislation or regulations that are believed needed at this time in order to promote sounder, more progressive, or more efficient banking operations?

Yes. In recent years there have been a number of exhaustive studies of the banking and credit system which might be used as the basis for considering changes in banking legislation or regulations in order to promote sounder, more progressive and more efficient banking operations.

Among the more immediate problems are (1) a more uniform interpretation of existing statutes and regulations by the bank regulatory agencies, and (2) a review of the administrative procedures of the regulatory agencies which supervise the banks of the nation.

President Moorhead stated that it was important to formulate a detailed and comprehensive compilation of constructive suggestions regarding necessary banking legislation; a great deal needed to be done in this area, and the Council stood ready to render all possible assistance. He pointed out that several exhaustive studies had been made in recent years suggesting what was needed in the way of legislative reform, and now it was time for action without further delay.

Mr. Day commented that one of the major problem areas lay in the confusion and inconsistencies generated by differences of approach among the three Federal supervisory agencies, a conflict brought into focus by the recent announcements of conversion of two large member State banks to national charters because of the competitive disadvantage which they felt vis-a-vis national banks in their former status.

Mr. Watlington agreed that the supervisory conflict was of concern to the banking community and that it posed a severe handicap to effective operations. When the competition offered by savings and loan associations was added to the picture, State banks were doubly disadvantaged in their operations. He suggested that this subject might profitably be made the sole topic of consideration at some early meeting of the Federal Advisory Council.

Mr. Hickok said that he was disturbed by the talk on the part of member State banks regarding the advantages of a national charter; if some definitive steps were not promptly taken to resolve the competitive imbalance between State and national banks there would be an increasing trend to conversions.

Governor Mills inquired whether there was no sentiment in the banking community that the supervisory concepts of the Board, which are predicated upon an insistence that sound and conservative banking practices be followed, should be a rallying point for bankers in the supervisory dispute.

President Moorhead made the statement that unfortunately there appeared to be more disposition toward the view that the Comptroller of the Currency was attempting to bring enlightened administration to bear on supervisory questions, while the Board held to a comparatively rigid and negative position. One example cited was the fact that bankers found the Board to be slow in giving answers to matters presented to it, whereas more expeditious treatment was generally accorded by other agencies.

Mr. Watlington reassured the Board of the admiration felt for it both personally and institutionally. However, many bankers felt the Board might better serve its purpose if a more liberal supervisory philosophy were to be adopted. As an example of one disturbing factor, he stated that the Board alone, among the Federal authorities concerned with bank mergers, would not give advance indication of the degree of favor a proposed merger would be accorded if and when presented. While he did not mean to suggest that the Board should relax the standards heretofore applied in evaluating matters requiring its approval or consideration, Mr. Watlington indicated that a greater willingness to discuss various problems arising in connection therewith would help to improve the Board's image in the banking community.

Mr. Murphy said that the present situation involved a clash of supervisory and operational philosophy regarding the State banking structure versus national banks. In his experience, bankers tended to lean in the direction of the former and to support the Board's administration of the regulatory framework applicable thereto. He was not aware of any chain reaction of discussion among bankers showing a preference for national charters, although evidence of such thinking in some quarters suggested the virtue of reviewing the basic ideas of supervision held by the Board. In sum, there appeared to have been some erosion of adherence to principles of conservative banking; the member State banks, looking to the Board as the keystone of sound philosophy, would like to see steps taken that would forestall further erosion. The Council was a good source of grass roots thinking about the problems involved in the current controversy. There was considerable merit to the suggestion that detailed reflection be given the subject with a view to comprehensive discussion at a subsequent meeting between the Council and the Board.

Mr. Cook raised the point that the Board's supervisory outlook was not solely responsible for the relative disadvantage State banks suffered in competing with national banks; in many cases State laws were more restrictive than the comparable Federal statutory provisions applicable to national banks, such as the allowable lending limits on real estate. Such disparity in statutory restrictions was detrimental to sound banking; there should be harmony between State and Federal banking legislation.

Chairman Martin stated that the Board was faced daily with problems arising out of the dual banking structure in this country and would welcome all constructive suggestions for dealing with them. When Mr. Breidenthal inquired whether the Board felt that it had been aggressive enough in resolving issues relating to conflicts in supervisory philosophy, the Chairman replied affirmatively. He went on to say that in his opinion the banking community was beginning to appreciate some of the shortcomings of a "divide and conquer" approach. Referring back to a previous comment, he also noted that he and other members of the Board as well as its staff had devoted many hours to discussing prospective mergers with interested persons, but informal approval prior to submission of the proposals to the Board was not feasible because no one could commit a group of seven men in advance. By contrast, the Comptroller of the Currency, being one man, found it more feasible to make advance commitments. As to speed of action, there had been occasions in which the Board might have acted with more dispatch, but by and large he felt most matters were handled as expeditiously as possible consistent with careful consideration. However, he expressed appreciation for the frank comments on the desirability of prompt action and stated that continuing effort would be made in this direction.

Mr. Breidenthal expressed interest in the Board's view of the consequences where a national bank were to follow a position advocated by the Comptroller of the Currency, such as counting undivided profits as capital in calculating lending limits, and thereby violate a ruling of the Board.

Chairman Martin replied that at least some of these were essentially legal questions, and neither the Board nor the Comptroller could state unequivocally which supervisory interpretation of the law would be sustained by the courts if submitted to judicial review.

Mr. Breidenthal then inquired whether in the event a national bank violated a regulation of the Board or ruling issued thereunder, any action would be taken if the Comptroller of the Currency chose not to act.

Governor Robertson responded by saying that since the Comptroller is the primary supervisory authority with respect to national banks, the Board probably would not feel it appropriate to take disciplinary action on its own initiative. He pointed out, however, that the directors of the bank would be subject to individual liability for any loss resulting from a violation of law or the Board's regulations.

Returning to the subject of the Board's conservative and deliberate approach to supervisory action, Mr. Day commented that when the Board had supervision of common trust funds, bankers had tried for years to have the $100 thousand limitation removed, without success; but when jurisdiction over such funds was transferred to the Comptroller of the Currency in 1963 he promptly did away with the ceiling.

Governor Mills commented that the advantages accruing from the Comptroller's action in the removal of the $100,000 limitation could be largely offset by tax considerations if an unfavorable ruling should be forthcoming by the Internal Revenue Service due to the extension of the field for use of common trust funds authorized by the Comptroller.

Governor Robertson noted that the Board had spent several months working on a revision of the regulation dealing with common trust funds, including attention to the $100 thousand ceiling, prior to its transfer to the Comptroller's jurisdiction, and the Comptroller had the benefit of this extensive study to aid him in issuing the new regulation.

Mr. Watlington referred once more to the matter of advance clearance with the Board concerning contemplated bank mergers. While he appreciated the fact that a body of seven men could not be committed to a position prior to consideration of an application, perhaps the Board could delegate authority to one member to indicate in advance the probable treatment of an application.

Chairman Martin pointed out that the Board had no legal authority to delegate any of its statutory responsibilities to a single Governor. In any event, an advance clearance procedure could hardly give a guarantee of ultimate approval, unless it was based on full consideration of an application.

Chairman Martin once more expressed appreciation for the frank observations made by the Council members concerning problem areas of the Board's supervisory responsibilities and activities; the Board would be delighted to receive further views from the Council.

At a later point in the meeting, pursuant to a request by Governor Robertson, discussion returned to the matter of banking legislation.

Governor Robertson stated that he was heartened to see the active concern manifested by the Council that a legislative program should be pursued vigorously. Many bankers as well as the public were concerned about the problem. In his view, the banking community should get behind legislation it favors before unwanted legislation intervenes, and in this connection he emphasized that it was important for the Council to develop ideas regarding a desirable program to this end. He did not believe bankers could continue to live with the situation that existed today.

President Moorhead said that he heartily agreed. There had been exhaustive studies in recent years by different groups, and he did not believe it necessary or desirable for the Council to have a large staff make additional such studies. It would seem feasible for the Council to review these studies, however, and to give the Board its ideas on what it would favor, as well as what it believed the public desired. He wondered whether the Board would welcome such views from the Council.

Governor Robertson said that he would welcome such views, and he was confident the other Board members felt likewise. The groundwork had been done and now judgments were needed based on the information accumulated.

Mr. Watlington advanced the thought that it would be presumptuous for the Council to undertake, on its own initiative, the submission of recommendations to the Board relative to the legislative reforms that should be sought. At the same time, if the Board should request the Council's assistance in developing a judgment as to the most desirable components of a comprehensive proposal for new legislation, he felt that the membership would be pleased to comply.

Chairman Martin reassured the Council that it was regarded as part of the System's official family, and its participation in the important decisions that had to be made concerning new banking legislation would certainly not be presumptuous; indeed, it would be welcomed by the Board. Many groups were devoting attention to this matter, and one of the most crucial areas of decision lay in the direction of deciding how aggressive the Board should be in pursuing a program of statutory revision. In this matter, he stated, the Board would find the Council's collective judgment most helpful.

Mr. Martin observed that he had been a member of one of the nongovernmental groups studying the question of updating the banking laws. He was aware of the value placed by such groups upon having detailed background information of a factual nature concerning the problems involved before drawing conclusions about reforms to be proposed. In the course of his comments, Mr. Martin raised the question where the initiative should properly rest for keeping the banking statutes responsive to the needs of the times. If one were to suggest a Federal Banking Commission as an appropriate agency, the question then would be how such an agency could be restrained from developing a monumental bureaucratic structure. As a point of departure, he felt that it was necessary to establish where responsibility should be for future reappraisal, review, and revision to keep the banking statutes up to date.

Governor Robertson responded that the primary responsibility for keeping banking legislation responsive to the needs of changing times and circumstances should be borne by the agency charged with administering the law. For example, every year the Board reviewed the statutory framework within which it must operate and the regulations it had issued thereunder, and the Board was fully aware of the responsibility it had to do this. Second, with particular reference to drafting of the Board's proposed Regulation F, Securities of Member State Banks, the Board had sought the counsel and advice of the American Bankers Association and had suggested that the Association create a standing committee to keep related accounting principles under constant review, so that the Federal supervisory agencies could be advised promptly of developing disparities between such principles and the financial reporting requirements of Regulation F or its counterparts issued by the other agencies. Governor Robertson was of the opinion that, in the final analysis, the most effective solution to the problem of keeping statutory and regulatory provisions up to date was for close and continuing cooperation between the supervisory agency or agencies and the private sectors of business affected, since only in this way could there be assurance that the agencies would be sensitive to the needs of those being supervised.

Chairman Martin concluded discussion of this topic by reiterating that the Board would appreciate having the Council undertake a study of the matter of an effective legislative program.

President Moorhead assured the Board that the Council wished to be helpful and that it would be pleased to undertake such a study.

4. The Board would be glad to have the Council's evaluation of the current and prospective U.S. balance of payments problem, particularly the bank credit component.

Although progress has been made in reducing the deficit in the balance of payments and in providing arrangements which afford us time to redress the deficit, the final solution continues to be difficult and elusive. Thus, while the trade surplus has been growing, Government overseas expenditures continue to be the major factor in the balance of payments deficit.

The demand for credit from foreign borrowers is strong and banks are under continuing pressure to accommodate this demand. Most bankers link the bank credit component with world trade and point out that bank loans to foreigners are necessary to finance an expanding volume of international trade. The interest equalization tax has been a factor in the increased volume of foreign bank credit. However, the imposition of the tax on bank credit, without any change in availability, would not necessarily reduce the outflow of capital

Governor Daane observed that while Government expenditures abroad were a significant influence on the United States balance of payments, efforts had been made to reduce substantially the dollar drain from such outlays. He did not feel that such expenditures should be labeled the culprit, and he noted that another major influence was private capital outflow.

President Moorhead inquired whether the Government's move to reduce foreign spending had been successful in mitigating the balance of payments problem.

Governor Daane replied that the efforts to date had not been entirely successful, although the Administration was committed to a policy of remedial action which, it was hoped, would result in a net reduction from mid-63 of about $1 billion in the dollar drain from such spending abroad. He added that almost $500 million of the $1 billion hoped-for reduction had been accomplished.

Mr. Murphy felt that it would be difficult to ascribe too much responsibility for the present imbalance in international payments to domestic bank credit underlying capital remittances abroad. In his view, the volume of capital outflow was not staggering, and in any event a substantial proportion of the short-term private capital going abroad usually found its way back to this country in one manner or another. For the good of the country, he was glad the recently-imposed interest equalization tax did not apply to bank loans abroad. Such loans were an important stimulus to international trade, and the remittances were almost invariably recovered, with interest. In addition, loans to foreign borrowers usually were related to transactions involving American principals, which was beneficial to their economic interests. In essence, therefore, he was convinced that bank loans abroad actually helped the United States' balance of payments position, since they aided in promoting exports and came back into the country with interest, unlike Government military expenditures.

Governor Daane commented that the real question was whether there was evidence that bank credit was being substituted for foreign capital issues in U.S. markets.

President Moorhead said that he thought there was no question but that this was the case, and Mr. Murphy said that some shift in that direction had occurred. The latter added that bank credit generally was for short-term, while capital issues were for longer periods. Short-term bank loans were not a complete substitute for capital issues to which the interest equalization tax applied, although there was a little seepage of the type described.

Governor Daane then inquired whether applying the interest equalization tax to bank loans to foreign borrowers would effectively deter the flow of capital abroad, or whether some seepage of bank loan credit could still be anticipated.

President Moorhead responded that in his view the penalty caused by the interest equalization tax would not be sufficiently severe to eliminate all foreign loans, since the over-all cost to the borrowers would still make some transactions attractive.

Mr. Murphy concurred, commenting that the basis for this conclusion was essentially one of comparative money rates; those in the United States were so attractive in comparison with the world rate that even superimposing the interest equalization tax did not eliminate the advantage of borrowing here. He added that by the foregoing observation he was not suggesting the discount rate in this country should be manipulated as a mechanism to meet fluctuations in the balance of payments position, since a stable discount rate had advantages from the standpoint of a sound, rather than a speculative, business climate.

5. Do the Council's views regarding the appropriateness of current monetary and credit policy accord with those expressed in the policy statement adopted by the ABA's 90th Annual Convention? What tendencies in the economy would the Council cite in support of its views in this matter? Specifically.

The volume of excess reserves has been steadily reduced with a gradual lessening of credit ease, which is in accord with the previously expressed views of the Council and we believe with the broad objectives outlined in the policy statement adopted by the ABA's 90th Annual Convention.

A. What evidences, if any, do the members of the Council see of inflationary tendencies developing in the economy?

The members of the Council believe that the trend of recent wage settlements and the negotiations now taking place in the auto industry, as well as those soon to begin in steel, point to growing pressures on costs that may finally be reflected in prices. The recent rises in prices of nonferrous metals and in the spot commodity price index in general are further evidence of some inflationary tendencies.

B. What are the views of the Council as to price prospects for consumer goods, machinery and industrial equipment, and primary materials?

As a consequence of these developments, rises in prices of primary materials seem likely, to be followed by possible increases in prices of machinery, industrial equipment and consumer goods.

President Moorhead stated that the Council was in basic agreement with the position taken by the American Bankers Association regarding monetary and credit policies at its 90th Annual Convention, observing that the Council has, by and large, been advocating the same line of thinking for some time. While there were a few areas in which the matter of definition of terms left some uncertainties or ambiguities in just how far the Association and the Council were in harmony of thought, there was general accord with the former's entire policy statement.

There being no further substantive discussion, it was agreed that the next meeting of the Federal Advisory Council would be scheduled for February 15-16, 1965.

Messrs. Breidenthal and McRae offered their sentiments of appreciation for having had the privilege of participating in the work of the Council during their 3-year terms of membership that would conclude this year.

The meeting then adjourned.

Secretary