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. Robertson  
Gov. Shepardson  
Gov. Mitchell  
Gov. Daane  
Gov. Maisel  
Gov. Brimmer

1/ Meeting with Presidents of the Federal Reserve Banks.
A meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks was held at the Federal Reserve Building in Washington, D. C., at 9:30 a.m. on Tuesday, August 23, 1966.

All of the members of the Board except Chairman Martin were in attendance at the meeting, along with all of the Reserve Bank Presidents. Other attendance from the Board and the Reserve Banks was essentially the same as at the meeting of the Federal Open Market Committee that convened following the adjournment of this joint meeting.

The purpose of this meeting was to discuss a staff draft of a proposed memorandum regarding the coordination of discount administration with other monetary policy instruments. The preliminary draft statement had been prepared at the Board's direction and had been distributed to the Presidents under date of August 19, 1966.

Vice Chairman Robertson said the Board felt that the problem was a very real one which should be resolved quickly. As all were aware, in the past few months a significant degree of tightening had been achieved through monetary policy, but unfortunately the impact of that tightening had been felt more heavily in some areas than others. The types of credit that were being tightened least were those that in some respects were the most inflationary and unsustainable. On the other hand, housing credit had been hit particularly hard, and State and local Government financing might also be facing a real pinch in the near future. This differential impact was typical
of previous periods of tightening. The Board had endeavored to offset it by moving in the area of reserve requirements and by refusing to move on Regulation Q ceilings. There were no plans for alleviating pressure on CDs by moving Q ceilings for the time being. The Board hoped that the System could achieve a greater effectiveness of policy than achieved thus far through an adaptation of discount policy. Therefore, the Presidents had been given a proposed program, on which he hoped everyone would feel free to comment.

This was something about which the Board felt fairly keenly, Governor Robertson said. There was probably going to be a need to continue tightening through monetary policy, which was carrying the load in the absence of fiscal restraint, in order to deal with inflationary pressures. There would no doubt be further liquidity pressures, and without effective policing of the discount window there was likely to be a further dumping of municipals by banks onto an already congested market. There was also a need for curtailment of business loans.

There were limits beyond which the Federal Reserve should not go in terms of being specific with respect to particular types of borrowers, but the System could at least exercise prudent pressure in an endeavor to obtain curtailments in those areas that were most inflationary. This could be done by adjusting discount administration. Banks that came to the window without any indication that they were attempting to curtail their expansion of credit should not be welcomed
The Board would propose to give careful consideration to the view expressed today, and then formulate the program and send it to the Reserve Banks. From then on it would be a System proposition. He was hopeful that the Presidents would call in officers of the principal banks and discuss the program with them.

Governor Robertson said that personally he was not bothered by interest rates as such. However, he was bothered by the expansion of credit, particularly in the business loan area. What the Board was seeking, he added, was even-handed administration of the discount window. Different kinds of operations in twelve Banks could not be afforded. Further, a program must be devised that could become effective immediately. The Board would propose to give careful consideration to the views expressed today, and then formulate the program and send it to the Reserve Banks. From then on it would be a System proposition. He was hopeful that the Presidents would call in officers of the principal banks and discuss the program with them.
The Board would not propose to make whatever statement was adopted a public document, at least until the bugs were ironed out, Governor Robertson continued. It was not possible to change administration of the window in one jump, and there would undoubtedly be problems, but they should be avoided to the extent possible. If borrowing increased, there would be a stronger case for the use of a price mechanism (the discount rate) as a means of policing, but in his opinion that point had not yet been reached. At the moment the mere fact that the discount rate was out of line with market rates did not affect the administration of the window, at least in his judgment, but the point could be reached where a discount rate move would have to be made. At that point the System would have to face the consequences and move. There might be real flaws in the program outlined in the staff draft memorandum. The Board had devoted considerable time to it, but realized that the Presidents had not had much opportunity to go over it.

Governor Brimmer said, on the question of a public announcement, that because this was such a substantive change in the approach to the window, he would hope that at some point early in the process some kind of public announcement would be made to clarify the underlying rationale. He thought it vital that not only banks but borrowers have an appreciation of what was involved.

Vice Chairman Robertson then called for views around the table, and President Hayes said he had qualms aside from some important substantive questions. Such a fundamental change was involved that if
the views of the Presidents were to be given some weight a one-day perusal of the memorandum hardly allowed time for the preparation of considered views. This was the kind of change that could profitably be discussed by the whole System over a period of weeks, rather than hours, before it was put into effect. He understood from Governor Robertson's comments, however, that there was an intention to put it into effect immediately. This raised difficult questions for the determination of open market policy over the coming weeks, and therefore it was probably necessary to clarify this particular issue in advance of the open market meeting, though he was frank to say that whatever resolution was made of the matter, difficult problems might be created in terms of open market policy.

President Hayes then said that the Board staff's draft memorandum seemed to be predicated on the premise: (a) that the present primary reliance on open market operations was inadequate to achieve the desired policy goals; and (b) that developments arising from possible large run-offs of CDs, combined with other losses of funds and large seasonal demands, could not be handled by the discount window under the present interpretation of Regulation A. The memorandum further stated that a current goal of monetary policy was to achieve "a somewhat better balance of such restraint (of credit growth) among the various categories of final credit users." It was by no means certain that this was a position which could be identified with any specific System decisions.
The procedures proposed in the memorandum, President Hayes continued, would in effect establish a separate lending procedure to meet additional borrowing needs arising from specific enumerated circumstances. The "additional adjustment assistance credit," under the proposed policy, would be made available under an extended interpretation of the meaning of Regulation A, and the credit's duration would depend on commitments involving a specific program on the part of the borrowing bank to tighten its loan policy and to take specific steps towards rebuilding liquidity. Normal lending under the present interpretation would be continued, but it was not clear how the two would be distinguished and coordinated. Apparently, only borrowing under the new procedure was to be offset automatically by open market operations. The memorandum implicitly raised, but did not specifically answer, difficult questions with regard to the coordination of discount policy with open market operations. It had little to say about System coordination of the implementation of the proposed policy and the setting up of workable and uniform criteria for implementing the new program.

The new policy proposed in the staff memorandum came close to placing the discount window in the position of providing guidance to the borrowing banks with regard to the distribution of credit, without ever stating specifically that the purpose of the new policy would be to reduce business loans. If reduction of lending to business, in
particular to large corporate borrowers, was to be a declared purpose of current Federal Reserve policy, it was doubtful that the suggested broadening of the interpretation of Regulation A was the best means of achieving it. Moreover, it was likely that large corporations would be able to obtain elsewhere funds denied by the banking system, and that they would be willing to pay the required price.

It appeared to him, President Hayes said, that it was entirely feasible to accommodate, without any essential change in the methods of administering the Reserve Bank discount windows, any borrowing needs that might arise from pressures on bank reserve positions discussed in the Board staff memorandum. Borrowing to permit orderly adjustment of lending and portfolio policies to massive losses of CDs (or other types of volatile funds) would be consistent with the spirit and current application of Regulation A. He would expect—and welcome—an increase in borrowing by New York money market banks in the weeks ahead. Indeed, this would be the automatic effect of any tightening through the tested instrument of open market operations. But placing on the discount window a vastly enlarged responsibility for supplying reserves in the coming months would involve many complex problems for the System, the banking system, and financial markets. The System was not adequately prepared to make such a shift, and it was undesirable to undertake a fundamental change under present conditions. Proposals as sweeping as those submitted required and deserved more than one
day's cursory study. It might be that the fundamental reappraisal of the discount mechanism now under way would suggest the desirability of significant changes in the role assigned to the various tools of monetary policy, but there did not seem to be any need to undertake a basic shift now.

Some of the policies and procedures discussed in the memorandum could be put into effect independently of the proposed change in Regulation A, President Hayes said. In particular, a better coordination of discount and bank supervisory activities was needed better to link discount window assistance to the observation of proper liquidity policies. It would be a mistake, however, to insist on a rebuilding of bank liquidity at a time when banks might properly be expected to make use of liquidity cushions built up against volatile deposits, including certificates of deposit, to absorb at least part of the expected losses. It might also be feasible and desirable to improve the flow of information on bank lending and borrowing, in particular for money market banks. He had considerable doubt, however, whether it would be possible to obtain meaningful statistics on lending commitments as an advance indicator of bank lending activities.

Some aspects of the proposed policy needed considerable study because of their ultimate implications—for instance "temporary credit extensions to finance, directly or indirectly, minimum underwriting activities essential to the continued functioning of securities markets."
It was President Hayes' opinion that to implement a new policy along the lines outlined in the memorandum, a public announcement would be required; and that such an announcement might create the impression of an easing of reserve policy. Moreover, unless open market operations offset the bulge in reserves stemming from the added borrowing, the extra reserves could provide the basis for undesirable credit expansion. Such operations, however, might contribute to confusing and disturbing the market.

In summary, then, it appeared to President Hayes that there was no compelling need to resort to a radical change in the implementation of discount policy to achieve present monetary policy goals and to meet any pressures that might arise in the near future. In view of the present highly sensitive state of the market, this did not seem to be the proper time to experiment with new policies that involved complex adjustments in reserve flows and might therefore result in confusion among market participants and possibly have perverse effects on the rate of credit growth. He did not see how the Open Market Committee could hope to reach a meaningful consensus on open market operations and devise proper instructions to the Manager if the proposed discount policy were to be put into effect in the next three weeks.

Mr. Ellis said he had some questions that required response if the Reserve Banks were to try to implement the program responsibly.
Conversations with large banks in the First District showed clearly that they expected to rely on the window to meet unusual problems associated with the change in reserve requirements, the tax and dividend dates, and run-offs of negotiable CDs. The press release issued by the Board in connection with the change in reserve requirements had built up that expectation; now came the staff memorandum having as its theme a suggestion that these member banks be permitted a longer than normal borrowing period in exchange for a commitment to adjust lending policies.

His first question, President Ellis said, was what the Reserve Banks would offer to the borrowing banks in terms of borrowing facilities beyond those they would rightfully expect to be available to them at present. That would be the first question the banks would direct to the discount officers, and the program would have no ready acceptance until the Reserve Banks could supply the answer. There must be a definition, in specific terms, of weeks of unchallenged borrowing. If that answer was given, however, it would mean some lessening of the tightening posture of monetary policy to make it easier for specific banks to readjust their positions, which they were in fact going to have to do anyway.

Mr. Ellis' second question related to the degree of formality of the program. Were the commitments referred to in the staff memorandum to be in writing? Were the commitments to be in some defined
form the Reserve Banks could measure? The memorandum spoke of
demonstrating that tighter lending policies were being followed,
which meant that there must be a reporting system. If the program
was really intended to be that formal, then it stopped short of
adequacy because it was not sufficiently specific and comprehensive.
On the other hand, it proposed to do much more than could be accom-
plished under an informal program, without written commitments and
reports.

His third question, Mr. Ellis said, was how active the Reserve
Banks should be in promoting the program. Normally member banks were
allowed to borrow for short periods without much question. A Reserve
Bank ordinarily did not request information on the first occasion a
bank showed up at the window. It assumed the borrowing was temporary,
and in most cases correctly. Under the proposed program, however,
unless the Reserve Bank launched requests at the onset of each borrow-
ing, banks would be able to avoid the program. There was also the
question of the degree of involvement of the Reserve Banks in urging
realignment of assets and restoration of liquidity positions, even
after a bank was in position to discontinue borrowing. It would be
a new and somewhat different policy objective if the Reserve Banks
became arbiters of the allocation of credit among final users. This
raised the question whether Federal Reserve infringement on management
prerogatives would be helpful in longer-range relationships with member
banks.
Mr. Ellis said his difficulty in resolving these questions forced him to the conclusion that the Federal Reserve should strive during the period immediately ahead to intensify present efforts to encourage and guide banks to restrain their lending activities without the complication of imposing a new formal program, with all the troubles that would necessarily be involved if it were placed in operation on short notice and with all the upsetting factors that would go with such an approach.

President Irons commented that the last paragraph of the Board’s press release on the change in reserve requirements might have been sufficient to cause a number of bankers to contact the Reserve Banks to find out what change was taking place. In view of this release and the press reports thereon, it seemed to him that a further announcement would be almost necessary, and such a release would have to be written with great care in view of the differing interpretations that had been placed on the earlier release.

On preliminary review of the staff memorandum, President Irons said, he felt that the Reserve Banks probably could accomplish under the present Regulation A all that needed to be accomplished in the present circumstances. He failed to see how credit could be extended liberally with one hand and tightened with the other hand. In the Eleventh District there would be more banks involved in, or at least stimulated by, this program than might be thought at first. Normally,
one would think of relatively few banks being active in the Federal funds market, but reports on Federal funds transactions now being obtained by the Dallas Bank on a weekly basis showed that some 180 member banks had been buying or selling Federal funds during the last reporting period. If Federal funds dried up, this would affect not only the largest banks in the District, with their built-in deficit positions, but also perhaps numerous country banks who could be cut off from loans from their correspondents. The proposed program would generate in the minds of bankers an expectation of funds being more readily available than before, and in that kind of situation the window would be hard to administer. If aggressive banks caught in the run-off of CDs were fitted in under the program, they might take 10 days, 30 days, or even 3 months to work their way out. At present, if such a bank should come to the window, the Reserve Bank would discuss its position and let it have some money for, say, three days, following which that bank would come back and the Reserve Bank would take another look. In this manner discount window administration tends to keep pressure on the bank.

Problems could arise, of course, as a result of the circumstances foreseen in the staff memorandum, President Irons observed. But he was not sure they were of such nature that the Reserve Banks could not meet them under Regulation A, as pressure developed through a run-off of CDs, without opening a door that would liberalize the
discount window. A lot of terms were used in the memorandum that were not defined timewise, and that also might create problems. In fact the proposed program would almost amount to setting up two standards, if the System retained Regulation A and at the same time introduced the new program. Many banks which had become liquid had been meeting their requirements in one way or another. Those banks apparently would be expected to stay under Regulation A. However, other banks that had been reaching out more aggressively were now being told that the Federal Reserve would work the problem out with them. This could produce a discriminatory situation.

In summary, President Irons said, he thought the situation was not so pressing that the System must take action today or tomorrow. He noted that a fundamental reappraisal of the discount mechanism was in progress. While that study obviously would not be completed for some time, he felt that the System could attempt to meet the current situation with its present tools, programs, and regulations--deviating whenever necessary to meet any unusual situation. With or without the proposed program, he considered it important that the discount departments of the Reserve Banks keep in close informal contact with each other to assure that they were operating along similar lines. It was important for the people at each Bank to know what other Banks were doing in certain situations.

Governor Mitchell, as Chairman of the Steering Committee for the Fundamental Reappraisal of the Discount Mechanism, commented that
the study had three or four major focal points. One related to the experience at the discount window in the various Districts and the differences in treatment of similar borrowing situations. This study indicated a disturbing lack of uniformity in administration of the window, and most of the evidence on Federal Reserve experience had been assembled. The survey also had established a link with the academic community, and it appeared that such theoretical and practical suggestions as were going to come from those quarters were already in, although contracts had been entered into for some additional studies by two or three individuals. The discount study group was still wrestling with the problem why some banks borrowed and some did not, and with the problem of the relationship of borrowing from the Federal Reserve to borrowing from correspondent banks. The committee and staff had given some attention to the relative reliance that should be placed on rate and administration. The fundamental question was whether it would be desirable to lighten the task of administration by increasing the role of the discount rate, and the time was getting close for debate of the issue within the discount study group and the System. If the System wanted to move in the direction of using the discount rate as the primary tool, with secondary reliance on discount window administration, it probably could take that course. However, his intuition told him this was not the time to change discount policy so drastically even though such a change might appear appropriate after the discount study had been completed.
President Swan said that, like President Hayes, he had some question about listing temporary credit extensions to finance minimum underwriting activities essential to the continued functioning of securities markets as a reason why borrowing member banks should be considered for greater than usual accommodation at the discount window. That seemed to represent quite a different thing from the other categories listed in the staff memorandum. He then asked why it was thought that the proposed program should be limited to banks that had gotten into an illiquid position because of CD run-offs or the drying up of Federal funds. Why should it not be applied to any borrowing bank? He was not sure of the distinction in terms of what the memorandum proposed to accomplish. In terms of attitudes to be taken, he had a question about the extent to which the Federal Reserve would be getting into particular uses of funds. The memorandum indicated that encouragement of a tightening of lending policies should not extend to Reserve Bank specification of what particular borrowers or classes of borrowers should be curtailed. However, what would a Reserve Bank's reaction be if a member bank tightened only in the real estate loan area? The question was how far the Reserve Banks should go in terms of types of lending, and he had considerable reservation about the implications of the memorandum and the application of the program. He also had a question about what the commitment figures would mean; they might mean different things to different banks.
President Swan suggested that if the program was approached in terms of minimum scope—emphasis on loan reduction against liquidation of securities—it seemed to him that this could be accomplished quite well within Regulation A. If all could agree on some facets of emphasis short of a complete new program, it might be better to see how that worked. He would expect a substantial run-off of CDs to lead to additional borrowing, and even under Regulation A the Reserve Banks would have to accommodate it.

If the proposed program were adopted, President Swan said, he would prefer to have some announcement made. However, if the System took minimum steps and tried to accomplish the necessary things within Regulation A, he doubted whether a further announcement beyond that contained in the Board's recent press release would be necessary. In any event, he felt that a substantial increase in borrowing could be expected, especially if the differential widened between the discount rate and the Federal funds rate. He did not think it was a question of rate versus administration; the two must go together. He hoped it would be possible to get a little help from a higher discount rate before the amount of borrowing grew substantially. If it was really felt that a great problem existed, consideration of getting some help from a higher discount rate should not be deferred until after the fact.

President Galusha said that the proposed program represented to him a disturbing change of a substantive nature in Regulation A. As
One who had practiced administrative law, he had a strong distaste for the practice of some agencies in changing public posture without changing their regulatory expressions. It seemed to him that a substantial modification of Regulation A was proposed when one tried to cure the problems of monetary tightness through the discount window by directing banks away from business loans. To him this was the first real new dimension added by the memorandum. The other new dimension was in allowing borrowings to continue for more extended periods than previously allowed. In his view the variety of banking problems found in individual applicants at the discount window was so mixed that it would be difficult indeed to achieve uniformity. It was necessary to look at each individual bank. It appeared to him that all the direction needed to accommodate the situation, that is, to tide banks over the possible run-off of CDs, was found in Regulation A, unless the intent was to change the approach of the Reserve Bank to the borrowing bank so as to investigate kinds of loans. If that was the intent, it would involve a substantive change that would be accomplished better by a revision of Regulation A.

President Scanlon suggested that if the proposed program was going to be adopted, the Board should give further study to some of the words used in it and give the Presidents a chance to study them. Some of the expressions would seem to lend themselves to better definition. He agreed with Governor Mitchell that the discount study did
reveal a lack of uniformity, but he did not regard the differences as being too serious. At any rate, the current proposal would only aggravate matters and lead to less uniformity.

President Scanlon said he felt that he was able to find in the foreword to Regulation A, and in the Regulation itself, authority to take care of the various situations that the guidelines in the draft memorandum were intended to cover. As he recalled, Governor Robertson had spoken of borrowing at the window as not having been excessive. Actually, the reason for absence of more borrowing was that the Reserve Banks had in effect told the member banks to stay away. If the Reserve Banks were to relax, borrowing would rise immediately. In the past six months the Chicago Reserve Bank had sat down on numerous occasions with the chief officers not only of money market banks but the larger reserve city banks and tried to lay the ground rules before them; in other words, get them to understand the rules of the game. The last paragraph of the Board’s recent press release had caused some of them to come in and raise questions. He was disturbed to hear several of the bankers saying that they thought the Federal Reserve was backing away from its program of restraint, that the Board had taken a mild action in raising reserve requirements and then more than offset the action by opening the discount window. He did not think that such a reaction was wanted or intended. If a further announcement was made, this should be cleared up.
President Scanlon said he did not feel it was possible to achieve both credit restraint and comfortable liquidity without specifying liquidity requirements by regulation. If liquidity standards were going to be set, he would favor having the supervisory agencies specify that banks had to maintain a certain liquidity. It was inappropriate to use this as a criterion for eligibility to borrow; it rather smacked of the compensating balance technique. The System needed to retain the posture that it was the ultimate source of liquidity for all member banks.

President Scanlon also felt that an attempt to distinguish between existing and new loans in determining eligibility to borrow would be difficult and ineffective. A change in total loans might be used for this purpose, but the Reserve Banks were in effect using that now. The first thing a Reserve Bank looked at, when a bank came to the window, was what had happened to its total loans.

President Scanlon noted that the draft memorandum stated that detailed reports on the purpose of borrowing would be required. He was not sure what the use of such reports would be, but apparently borrowing for some purposes would be offset by open market operations while borrowing for other purposes would not. He saw no logic in attempting to link the operations of individual banks with open market operations. If it was desired to promote any particular asset segment, there were ways to do this without opening the discount window to a policy that could have unpredictable results.
President Clay said he had no doubt but that the discount window should be used to supply funds temporarily for the variety of reasons outlined in the staff memorandum. However, he would have no difficulty in interpreting the present Regulation A to permit supplying such funds on a temporary basis. If the problems covered in the memorandum all rolled up together at one time, a massive movement toward the window could be expected without any more announcement than had already been made. As soon as banks began to see an increase in borrowings, they would come in and test the window. Very soon it would be necessary to have a price mechanism also at work in order to have orderly administration of the window. If the proposed program was instituted, the necessity of moving on the discount rate should be recognized.

President Clay thought it would be almost impossible to distinguish between traditional types of borrowing under Regulation A and borrowings for the purposes described in the memorandum. He thought the Reserve Banks probably would wind up by putting almost all borrowing on the basis stated in the memorandum. He added that he did not pretend to know how to run all of the banks in the Tenth District. He doubted that anyone around the table had the knowledge to run all of the banks in the respective districts. If a bank came to the window for reasons outlined in the memorandum, he would have no hesitancy in making suggestions as to what the bank might do to make the borrowing
period temporary, but he would ask the bank to formulate its own pro-
gram. It would have the judgment as to where credit was needed and
what was in the best interests of the bank and its community. He
would find it difficult to sit down with a bank and say that it must
stop making certain loans. The bank might find it could go into the
Federal funds market, do a better job there, and get through the period.

In summary, President Clay said, he thought the proposal was
unnecessary and carried the danger of moving the Federal Reserve into
the operations of the individual member banks. He thought this was
the wrong way for the Federal Reserve to move.

President Wayne said that, like President Hayes, he was rather
startled to read in the memorandum that it was the current aim of moné-
tary policy to restrain the pace of credit expansion, particularly
bank credit expansion, "while achieving a somewhat better balance of
such restraint among the various categories of final credit users."
He had not been aware that this was a part of current monetary policy,
and it was his feeling that the objective could not be achieved through
monetary policy. If the Federal Reserve tried to do that, it would be
undertaking to substitute the System's judgment for the managerial
judgment of the member banks. It was doubtful that the System was
qualified, and it was an illusion to think that the objective could be
accomplished. Actually, this was one of the original concepts of the
System--to direct the flow of credit into appropriate channels--but
the effort proved ineffective. If attempted in 1966, it would be ineffective and frustrating. Further, the effort would apply only to banks that came to the discount window.

President Wayne said the key banks in the Fifth District were aware of and concerned about the problem of rising business loans. However, it must be recognized that a commercial bank operates—properly—on depositor relationships. If the Federal Reserve moved into this area, it would be moving along a road of no return because it would have to be specific. Banks would say to the public that their refusal to extend certain credits flowed from accepting the System's advice. This would involve a vast change in concept and approach.

President Hickman said the proposal appeared to be designed to favor large money market banks that had relied heavily on CDs, RPs with corporations, etc., over smaller and more conservative banks. Like the change in Regulation Q last December, the proposal might be interpreted as an effort to bail out the aggressive banks from a liquidity squeeze, which was precisely the position they should be in under conditions of tight money. Second, unless the discount rate were raised to 5-1/2 per cent, the large banks would find it profitable to replace CD money with funds from the discount window. Third, it was not clear from the proposal, as stated, whether the Account Manager should absorb the reserves provided through increased borrowing or whether these reserves should be allowed to provide the base for multiple credit expansion. If the total increase of borrowed reserves
was not fully offset by sales into the market, credit creation would be inflationary. If it were fully offset, the System would be in roughly the same position as if it had not allowed the additional borrowing in the first instance. This raised the question whether the System could not help out the banks temporarily under Regulation A as now written, encouraging the banks to repay their debt in the shortest time possible.

Perhaps he was old-fashioned, President Hickman said, but it seemed to him there was a danger in trying to guide the banks too closely in their asset management. Complete control over bank assets is one way in which totalitarian governments control their economic systems. One of the principal advantages of general controls over selective controls in a free enterprise system is that there is a minimum of interference with market processes. Demand-pull inflation is caused by the fact that aggregate demand exceeds the capacity to produce. The most efficient producers are, by and large, the large corporations who are tied closely to the large banks. If business loans were further rationed by large banks, the capacity of the most efficient producers would be curtailed, thus leading to further inflation.

President Hickman noted that one of the ancillary purposes of the proposal was to counter bank sales of investments into the market; yet a major purpose of banks in holding such secondary reserves is to be able to liquidate them in periods of strong loan demand or credit
stringency. Banks hold liquid investments to liquidate them, not to hoard them in periods of credit stringency. In sum, he felt that the proposal should be given further study.

President Bopp asked what was really so different about the proposed new procedure, in view of the fact that at present one of the first things asked by a Reserve Bank was what had happened to a borrowing bank's deposits and loans. This was a usual circumstance in connection with accommodation under Regulation A. There were some differences in administration between Banks, and Regulation A was not precise. The proposed procedure would presumably add something precise to a base that was not precise, and it might introduce serious confusions. He noted that the memorandum stated that an "appropriate" level of liquidity could not be defined with any assurance, but that as a rule of thumb a discount officer might use as a normative value the liquidity position of the typical bank in the borrowing bank's reserve class and size range. The question of the ability to get accurate, meaningful, current information apparently had not been recognized.

Further, the memorandum said that borrowing banks should be asked to report regularly on their borrowings from non-Federal Reserve sources, in order to permit a suitable judgment of their liquid liabilities to offset against their liquid assets. He noted that the greatest liquid liability of a bank was its demand deposits. This was the very nature of banking; the meaning of liquidity in the case of banking was quite
different from the meaning in the case of a corporation. His suggestion would be that in any redrafting assistance be sought from people with general experience as discount officers, not only to make verbal changes in the draft statement but to determine whether the types of information described in the statement could actually be obtained.

President Patterson said he shared the feeling that administration of the discount window had been effective. A tightening had been achieved, and this was generally known among bankers. He would hesitate to get into the area of asset management without some definite criteria that could be presented to banks in order to let them know what was expected of them. While he was not opposed to the broad objectives of the program, he was opposed to the memorandum in its present form. A great deal of study was needed before adopting anything that might be regarded as an amendment of Regulation A.

President Francis said he supposed part of the problem reflected comments being heard from bankers and others about a liquidity problem this fall. At the same time, reports were also being heard from bankers and others about some anticipatory borrowing. In his view, the situation might develop to be something like the midyear problem of savings and loan associations. Some preparations were made, but the problem turned out not to be so difficult as it earlier appeared from some angles. In any event, he would be reluctant to make any announcement of basic changes in Regulation A or the discount function at this time,
lest this wind up being more of an invitation to excessive use of the
discount window than anything else. He shared the views already
expressed by several persons that Regulation A afforded the tools to
do about anything that could actually be read into the memorandum.
As to the special circumstances outlined in it, the St. Louis Bank
had been working for months with cases of that kind, more or less
with the view of helping the management of the banks concerned to
straighten things out. A move into some of the areas outlined in the
memorandum would appear to inject the System into portfolio manage-
ment, which was not where the System belonged. He sensed the possi-
bility that some of the implied commitments could develop into more
or less of an invitation to some institutions to use the discount
facility. He agreed with the thought that in all of this there was
implied some special advantage to less prudent bankers, and penalties
to those who had attempted to maintain an investment position that
would enable them to weather periods of this kind.

President Francis felt that if the problem developed in sub-
stantially the way indicated in the statement it should be made a
matter of policy to accommodate liberally through the window, rather
than through open market operations. He thought that without any
basic change in the present tools it would be possible to ride out
whatever might reasonably develop. He would hate to see the System
involve itself in something that might not work out as the System
would like.
Governor Mitchell noted that several people had said that they thought they could do under Regulation A about all that was implied in the memorandum. He felt this was true. The proposal was not brought forth as a new regulation; it was just an attempt to elaborate types of situations that might occur in the next month or so.

The Account Manager had been worried about the municipal market, and bankers who had been attempting to liquidate their portfolios also were nervous. The market was extremely delicate. The situation was apt to become more gloomy as the weeks unfolded and CD run-offs became larger. His view was that it was desirable to move toward more uniformity in the administration of the discount window—and here he was talking about the problems of the large banks and leaving out of account seasonal borrowing—if in fact a period was approaching when borrowings would be very large. The staff document was an attempt to try to pinpoint some of the problems that might arise. Many people had talked today about substituting the System's judgment for that of a member bank's management. Actually, the Reserve Banks had been doing some of that constantly. They had all talked to member banks about lending and investment policies. It was the way in which this was done that made it acceptable or unacceptable.

This was a period of monetary restraint, Governor Mitchell added, and it might be assumed that more restraint would be forthcoming, even if simply through the market tightening itself. Accordingly, there
was certain to be pressure on the discount window. The memorandum attempted to explore the problems and propose methods for dealing with those problems as they might develop. Fault might be found with some aspects of the staff memorandum, but the problems would still be there.

Governor Daane said he shared the philosophical bias expressed by a number of others against injecting the discount window into the allocation process. The System had seen the error of its ways when it attempted to do that in the early days. At present the market was extremely sensitive, and he agreed with President Hayes that this was not the time to experiment with an almost impossible chore of differentiation that could only lead to further confusion of banker attitudes. He would prefer to rely on the continuing efforts and good sense of the discount officers rather than to construct elaborate new rules and arrangements.

Governor Maisel observed that the problem involved was whether contingency planning should or should not be attempted. The basic question was what would happen if banks could not roll over their CDs and many of them came to the discount window simultaneously. How should the System adjust? Should it be assumed that it would adjust automatically under Regulation A? It seemed to him that it would not. There appeared to be a basic difference between the micro problem and the macro problem. The macro problem could not be solved by saying
that every bank that found itself in difficulty could come to the window and borrow as much as it wanted for several weeks. If banks came to the window, the question was what the System would say that it was going to do in this period. It was not a matter of dealing with imprudent banks. It was an effort to set up some general rules under which open market operations could be conducted during the next several weeks or months in relation to what was going on at the discount window.

The broader question, Governor Maisel continued, was whether the System was satisfied with the present thrust of monetary policy. There might be some question whether an aggregate policy was succeeding in doing what monetary policy was supposed to be doing. He saw no logic in the statement that the Federal Reserve should not be concerned with individual bank portfolios. The mere fact of the large increase in business loans made it necessary to ask whether it was desirable to continue along current lines. As he read the staff memorandum and listened to the discussion around the table, he felt that this was the second basic question: whether monetary policy was successful if the result was to have the types of distortions that had occurred in the present period of restraint.

Governor Maisel said he thought there was no other central bank that did not have a firmer policy along this line than was proposed in the staff memorandum, which suggested nothing very radical.
As he had said, he thought that the two basic questions to which he had referred were critical and must be decided, particularly the question whether the System was satisfied with the manner in which credit was now being distributed.

Governor Brimmer commented that the staff document had been drafted to help put into a systematic scheme some of the issues that might have to be faced. The reactions around the table today were not surprising in view of the short time the draft document had been made available to the Presidents and in view of the implied shift in discount administration, but he thought the document proposed a desirable change. He was not convinced that the System should refrain from innovating at all simply because it was in a difficult situation. Normally he tended to be conservative, and on several occasions he had stressed that the System should not innovate unnecessarily, but he was concerned about the differential impact of monetary policy. In his opinion, contingency planning was clearly indicated.

Governor Brimmer said he thought no one should have read the Board's recent press release as an open invitation to come to the discount window. The purpose was to say, in recognition of the action on reserve requirements and the failure to lift Regulation Q ceilings, that this necessarily implied some run-off of CDs. The intent was not to offer aid to overly aggressive and irresponsible banks, but rather to say that the System was not irresponsible and would not let
banks go down the drain because of liquidity problems. However, if banks wanted to be accommodated, then as a condition to their borrowing—other than regular seasonal borrowing—they ought to be willing to meet some of the objectives of monetary policy. In his view, the use of traditional instruments would not serve to cope with the present situation.

Governor Robertson commented that it should be clear that no amendment to Regulation A was contemplated. Instead, the purpose of whatever action was decided upon would be to provide uniformity among the Federal Reserve Banks in coping with the problems that seemed certain to lie ahead. From the System's standpoint, he was apprehensive about a monetary policy that had a major impact in only limited areas. There was a substantial body of opinion, he added, to the effect that the use of monetary policy had served only to push up rates, and that it had not served to curtail credit in such a way as to cut down on inflationary pressures. He thought it should be obvious to anyone who had read the Board's press release that the intent was not to open up the discount window. The purpose of the change in reserve requirements was to indicate clearly an intent to tighten monetary policy further in order to make it effective and put the System in a position where it could cope with the present problems. The current proposal was not designed to penalize the prudent lender and benefit the imprudent lender, or to bail out aggressive banks that had gotten into an
illiquid position. Rather, it was an effort to make clear that there were conditions attached to the use of the discount window, one being to obtain a curb on credit expansion. There might be differences of opinion as to just how to proceed. There might be questions as to whether the System would be interfering unduly with bank management. In any event, on the basis of today's comments the Board would proceed to work on the memorandum further to produce the kind of document that could be helpful to the System in coping with the problems that were going to be encountered at the discount window, not by way of amendment of Regulation A but by carrying out what he conceived to be the purpose of the Regulation and the general language used therein.

Governor Shepardson agreed with Governor Robertson's statement of concept as to the objectives of the proposal. He also agreed with the statements that had been made about the danger of trying to run a member bank's business. Nevertheless, it was his impression that in many cases Reserve Banks, in talking with member banks, had looked at their portfolios and suggested that they liquidate investments, even at a cost, in order to get out of the window.

Governor Shepardson added that last December it was hard to foresee so fast and so great a movement in interest rates. This movement had produced some distortions, more than the System would have liked to see. Presently the market for municipal securities was mentioned as being very tight. However, activity financed through
municipal offerings was in many cases not only desirable but essential, and the market must not be cramped too tightly. His thought was that the Reserve Banks, in counseling with member banks, would emphasize the desirability of cutting back some of their lending rather than forcing municipal securities onto an already congested market. It had not been his thought that the staff memorandum would involve a change in Regulation A or that it would be public. Rather it was a means of developing a common approach in order to achieve more uniformity in discount administration and in order to lay stress on restraint in lending rather than liquidation of securities.

In further discussion, President Wayne observed that the Reserve Banks would be pressed into being specific and then would be quoted. If the objectives were as indicated by Board members, they could not be realized effectively through the discount window. Instead, the System would have to state specifically that this was a time when credit should not be extended to certain areas, that is, if the System intended to become active in determining the uses of credit. This might be nothing radical in terms of what other central banks had done, but it would be quite radical in this country. So substantial a departure from traditional practices should not be undertaken lightly.

Governor Robertson commented that he was sure no one at this table would want to see the Federal Reserve undertake to pass on individual credit applications. However, the System should do everything
possible to see that those who utilized the discount window were willing to participate in a program designed to curtail inflationary pressures.

President Hayes said he shared the apprehension expressed by President Wayne that once the System embarked on a route of expressing preferences concerning types of borrowers, the end of the road could not be foreseen. There were always dangers, admittedly, of political interpretation as to what a central bank was doing. There was never a business expansion or cycle when the differential impact of monetary policy did not lead to a certain amount of criticism. The way to meet this was not to acquiesce in the correctness of such criticism but rather to hold to the general philosophy that the beauty of monetary policy lay in its impersonal quality. There were many ways of assisting specific segments of the economy to meet over-all Governmental policy, but he would regret to see monetary policy assume the role of trying to affect that outcome.

Governor Daane commented that if the proposal really represented a major change and involved a different System approach to implementation of monetary policy, then it was not merely a question of getting bugs out of the staff memorandum. Instead, the matter deserved full consideration by all parts of the System.

Governor Robertson concluded the meeting by requesting that the Presidents submit any further comments in writing this week, to
which he added that it might be necessary to call another joint meet-
ing of the Board and the Presidents.

The meeting then adjourned.