

MINUTES OF MEETING
OF THE
FEDERAL ADVISORY COUNCIL.

May 17, 1920
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A regular statutory meeting of the Federal Advisory Council was held in the Federal Reserve Board room, Metropolitan Bank Bldg., Washington, D C, at 10:30 A. M. Monday, May 17, 1920.

Present: Messrs. J. B. Forgan, President, L. L. Rue, Vice-President, Philip Stockton, A. B. Hapburn, W. S. Rowe, J. G. Brown, Oscar Wells, F. O. Watts, E. F. Swinney, A. L. Ball, A. L. Mills, and Merritt H. Grim, Secretary.

Absent: Mr. C. T. Jaffray, who telegraphed that he could not attend the meeting. That Governor Harding's proposition without going fully into the matter.

Mr. Forgan, President, called the meeting to order and stated that as Mr. Jaffray was not present Mr. E. W. Decker, had been asked by the Federal Reserve Bank, of Minneapolis to attend this meeting in his place. There being no objection to his doing so he was invited to sit in with the Council.

On motion of Mr. Rue, seconded by Mr. Mills the minutes of meetings of the Federal Advisory Council and of its Executive Committee held on February 16th and 17th, copies of which had been sent to members of the Council were approved.

The Chair stated that he had arranged with Governor Harding that he and several members of the Federal Reserve Board would join the Council at 11 o'clock and that the Board had invited the members of the Council to luncheon at 1:15 at the Metropolitan Club to meet the Secretary of the Treasury, who was unable to be present at the morning meeting.

Mr. Forgan also informed the Council that Governor Harding had requested him to lay before the Council a scheme he had personally thought of to refund outstanding Liberty and Victory Loan bonds by the issuance of forty years bonds bearing interest at 5% for the first five years, 4½% for the following ten years and 4% for the remaining twenty-five years, drawing attention to the fact that the total amount of interest paid by the government during the forty years period would be exactly the same amount as if the bonds were to run for that length of time at 4½%.

Conditions of the refunding bonds in regard to exemption from taxation

Minutes of Meeting

Immediately after lunch (at the Metropolitan Club) the Council

of the

May 17, 1920

went into joint conference with the Federal Reserve Board.
Federal Advisory Council.

All of the Council members were present and the following members of the

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etc., to be the same as they are now in connection with the various issues to be refunded; the long term bonds to be exchangeable for the short term bonds entirely at the option of the holders of the latter. After some discussion of the matter it was decided that the President should inform the Secretary of the Treasury at luncheon that Governor Harding's proposition without going fully into the matter in all its details impressed the members of the Council as being worthy of his careful consideration.

At 11:20 the following members of the Federal Reserve Board came in
Governor F. B. G. Harding, A. C. Miller, J. S. Williams and H. F. Moore.

Governor Harding extended the Board's invitation for lunch to meet the Secretary of the Treasury and stated that the joint conference with the Federal Reserve Board, the Federal Advisory Council, the Class A Directors of Federal Reserve banks and a committee appointed by the Executive Council of the American Bankers Association on "Orderly deflation of Credits" would meet tomorrow 18th inst., at 10:30 A. M. in his office.

Governor Harding then addressed the meeting at length on the credit situation and the necessity of preventing further expansion.

After a general discussion the members of the Board withdrew and the Council continued in session until one o'clock when it adjourned for lunch.

SECRETARY.

Federal Advisory Council.

3.

Immediately after lunch (at the Metropolitan Club) the Council
went into joint conference with the Federal Reserve Board.

May 17, 1920

All of the Council members were present and the following members of the
Federal Reserve Board: Messrs. D F Houston, Secretary of the Treasury, W F G Harding,
Governor, J S Williams, A C Miller and H A Moshlenpah.

Each of the members of the Council reviewed business and financial
conditions in his Federal Reserve District after which the Secretary gave an
outline of the probably prospective requirements of the Treasury Department.

On the suggestion of the Secretary of the Treasury the Council was
requested by the Federal Reserve Board to prepare a resolution to be laid before
the Conference tomorrow setting forth the present lack of transportation facilities
and the effect that the congestion at the principal railroad centers and at the
shipping ports is having on the banking situation in view of the present condition
of expanded credit, with the understanding that the resolution if adopted by the
Conference should be laid before the Interstate Commerce Commission and the United
States Shipping Board.

The joint session adjourned.

SECRETARY.

AFTER FIVE O'CLOCK ON MOTION OF MR. MILLER THE JOINT SESSION ADJOURNED.

9 A.M., May 1920.

SECRETARY.

Federal Advisory Council.
FEDERAL RESERVE BOARD

WASHINGTON 4.

May 17, 1920

Office Of The Governor

April 17, 1920

The Federal Advisory Council resumed its session at 3:30 in the Federal Reserve Board room, taking up Governor Harding's letter of April 17, 1920, copy of which is hereto attached and made a part of these minutes.

Mr. Forgan, Mr. Rue, Mr. Swinney and Mr. Mills read to the meeting suggestions for recommendations on the various topics submitted for the Council's consideration in Governor Harding's letter.

After an informal discussion of the topics Mr. Rue moved that a special committee of three be appointed by the Chair to formulate recommendations on them based on the views expressed. Motion seconded by Mr. Wells and carried.

The Chair appointed as such committee Mr. E. F. Swinney, Mr. A. L. Mills and Mr. Oscar Wells.

The matter of preparing a resolution in connection with the existing Railroad situation as requested by the Federal Reserve Board to be submitted for adoption at the conference tomorrow, was on motion of Mr. Swinney, seconded by Mr. Mills, referred to the Executive Committee. The Chair requested Mr. Decker to sit with the Executive Committee in the preparation of this resolution.

After five o'clock on motion of Mr. Watts the Council adjourned until 9 A. M., May 18th.

Very truly yours,
(Signed) W. P. G. Harding
Governor

Mr. James W. Forgan, President,
Federal Advisory Council.

SECRETARY.

FEDERAL RESERVE BOARD

WASHINGTON

Office Of The Governor

April 17, 1920

Dear Mr. Forgan:

Replying further to your letter of the 8th instant, I beg to advise that after full discussion the Board has decided that the only topics which it will ask the Federal Advisory Council to discuss on May 17th will be (a) "Causes of continued expansion of credits and of Federal reserve note issues", (b) "How can the reserve position of the Federal reserve banks be materially strengthened before the seasonal demand sets in next fall without undue disturbance of the processes of production and distribution", (c) "If steps cannot be taken at this time leading to a more normal proportion between the volume of credits and the volume of goods, when can they be taken", (d) "What is the effect upon the general situation of the increased Treasury borrowings and what should be the policy of the Federal reserve banks in establishing rates of discount on paper secured by certificates of indebtedness", (e) "Should there be a revision of rates on paper secured by Liberty Bonds and Victory Notes".

The Board is sending letters today to the Federal reserve banks requesting that the three Class A directors of each bank meet here on Tuesday, May 18th, for a discussion of the general credit situation. As these directors are representative of the member banks and are officers of institutions which not only borrow from the Federal reserve banks but also make loans to the public, it is the belief of the Board that an exchange of views would be helpful. At the conference reference will be made to charts showing graphically the changes in the reserve position and in the character of invested assets since July 1, 1919, of each of the twelve Federal reserve banks and of the Federal reserve system as a whole. The Board hopes that members of the Federal Advisory Council will come prepared to extend their stay in Washington in order that they may sit with the Board at this conference with the Class A Directors.

Very truly yours,

(Signed) W. P. G. Harding
Governor.

Mr. James B. Forgan, President,
Federal Advisory Council.

Minutes of the

MINUTES OF

May 17, 1920.

EXECUTIVE COMMITTEE

OF THE

FEDERAL ADVISORY COUNCIL.

May 17, 1920

Present: Messrs. James B. Forgan, President; L L Rue, Vice President;

Philip Stockton, W S Rowe, J S Brown, Oscar Wells, F O Watts, W F Selway,

L L Hall, A S Galle, and Messrs. H. W. ...

Hepburn, W S Rowe, F O Watts and by special request Mr E W Decker, also
Merritt H. Grim, Secretary.

The Executive Committee met at the New Willard Hotel and after dining together prepared the following preamble and resolution which subject to the approval of the Federal Advisory Council should be submitted to the Conference tomorrow. (See minutes of Conference, May 18th.)

The meeting then adjourned.

SECRETARY.

The Council then adjourned to attend the Conference at 10:30 A M in Governor Harding's office.

Minutes of the

RECOMMENDED Federal Advisory Council. FEDERAL ADVISORY
COUNCIL TO THE FEDERAL RESERVE BOARD

May 18, 1920

May 18, 1920.

Wm. W. P. G. Harding, Governor,
Federal Reserve Board.

The Federal Advisory Council met in the Federal Reserve Board room at 9 A M Tuesday, May 18th, 1920.

Present: Messrs. James B. Forgan, President; L. L. Rue, Vice-President; Philip Steckton, W S Rowe, J G Brown, Oscar Wells, F O Watts, E F Swinney, R L Ball, A L Mills, and Merritt H. Grim, Secretary, also Mr E W Decker.

Absent: Messrs. A B Hapburn and C T Jaffray.

The President called the meeting to order and laid before it the report of the special committee on the Federal Reserve Board's topics. After full consideration the Council unanimously adopted recommendations, copy of which in printed form is hereto attached and made a part of these minutes, and the President was requested to transmit them to the Federal Reserve Board.

The Executive Committee then submitted the preamble and resolutions it had prepared on existing railroad conditions which after discussion and some amendments were approved and left in charge of Mr Watts for submission to the Conference to be held immediately after adjournment of this meeting. (See minutes of Conference May 18th).

The Council then adjourned to attend the Conference at 10:30 A M in Governor Harding's office.

Secretary.

RECOMMENDATIONS OF THE FEDERAL ADVISORY
COUNCIL TO THE FEDERAL RESERVE BOARD

May 18, 1920

Hon. W. P. G. Harding, Governor,
Federal Reserve Board,
Washington, D. C.

My Dear Sir:

The Council has given consideration to the matters included in your communication of April 17th, and beg to reply thereto in the following manner, following the order set out by you:

TOPIC NO. 1.—“Causes of continued expansion of credits and of Federal Reserve note issues.”

Answer:

There are many contributing causes of which the following may be regarded as paramount:

1. We recognize, of course, that the first cause is the Great War.
2. Great extravagance, national, municipal and individual.
3. Inefficiency and indifference of labor, resulting in lessening production.
4. A shortage of transportation facilities, thus preventing the normal movement of commodities.
5. The vicious circle of increasing wages and prices.



TOPIC NO. 2.—“How can the reserve position of the Federal Reserve banks be materially strengthened before the seasonal demand sets in next Fall without undue disturbance of the processes of production and distribution?”

Recommendation:

By urging upon member banks, through the Federal Reserve banks, the wisdom of showing borrowers the necessity of the curtailment of general credits and especially for non-essential uses, as well as continuing to discourage loans for capital and speculative purposes; by checking excessive borrowings through the application of higher rates.



TOPIC NO. 3.—“If steps cannot be taken at this time leading to a more normal proportion between the volume of credits and the volume of goods, when can they be taken?”

Recommendation:

In our opinion steps should be taken now, as outlined in answer to the last question.

TOPIC NO. 4.—“What is the effect upon the general situation of the increased Treasury borrowings and what should be the policy of the Federal Reserve banks in establishing rates of discount on paper secured by certificates of indebtedness?”

Recommendation:

It is obvious that the borrowings of the Treasury have the same effect upon the general credit situation as those of other borrowers. The Council would suggest the wisdom of Congressional relief from the burden of government financing by a policy of rigid economy; the revision of the tax laws for the sake of a more equitable distribution of the burden without reducing the revenue; the enactment of the budget system, the budget to include provision for the gradual payment of the short time obligations of the Treasury. These would of necessity preclude unwise appropriations, such as the proposed soldiers' bonus.

In view of the large volume of Treasury Certificates of Indebtedness carried by member banks at the instance of the Treasury Department, we believe that rates established by the Federal Reserve banks on paper secured by them should not be materially greater than the rates borne by the Certificates.



TOPIC NO. 5.—“Should there be a revision of rates on paper secured by Liberty bonds and Victory notes?”

Recommendation:

From a survey of the present rates in force by the Federal Reserve banks it would seem that six per cent is now being charged on paper secured by Liberty bonds and Victory notes. In the judgment of the Council when and if any further revision of rates should be made there should be shown due consideration for the original subscriber of government securities.

(Signed) JAS. B. FORGAN, President.



The following members of the Federal Advisory Council were present at this meeting: Messrs. James B. Forgan, President; L. L. Rue, Vice-President; Philip Stockton, A. B. Hepburn, W. S. Rowe, J. G. Brown, Oscar Wells, F. O. Watts, E. F. Swinney, R. L. Ball, A. L. Mills, and Merritt H. Grim, Secretary.

Minutes of joint Conference
The Federal Reserve Board, the Federal Advisory Council,
The Class A Directors of the Federal Reserve Banks, and
a special committee of the American Bankers Association.

May 18, 1920.

A joint conference of the following bodies was held in Governor
Harding's office in the Treasury Building, Washington, D C Tuesday, May 18th,
1920, at 10:30 A M.

Hon. W F C Harding, Governor, in the Chair, Hon. D F Houston, Secretary
of the Treasury, Messrs. J S Williams, A C Miller, H A Moehlenpach, members of
the Federal Reserve Board; Messrs. James B Forgan, President, L L Rue, Vice-
President, Philip Steckton, A B Hepburn, W S Rowe, J G Brown, Oscar Wells,
F O Watts, E F Swinney, R L Ball, A L Mills, members of the Federal Advisory
Council, and Merritt H. Grim, Secretary; Messrs. James B. Forgan, Chairman
of special committee on "Orderly and proper Deflation of Credits" appointed by the Executive
Council of the American Bankers Association; and about thirty Class A Directors
of the Federal Reserve banks.

Governor Harding addressed the conference at length on the problems
confronting the Federal Reserve Board. A synopsis of his address is hereto
attached as part of these minutes.

Each of the Class A Directors present made brief remarks regarding
financial and commercial conditions in their districts.

There being a congestion of freight in practically every section of the
country, as indicated by the gentlemen who spoke, owing to the lack of facilities
of the railroads, on motion of Mr James B. Forgan, duly carried the chair was
authorized to appoint a committee of five to prepare a resolution to be submitted
to the Interstate Commerce Commission and the United States Shipping Board urging
the granting of increased rates and the proper distribution of shipping facilities
at the ports. Governor Harding appointed the following gentlemen to draft such

OPENING REMARKS OF GOVERNOR HARDING AT THE CONFERENCE
WITH THE FEDERAL RESERVE BOARD OF THE FEDERAL ADVISORY COUNCIL AND THE
CLASS "A" DIRECTORS OF THE FEDERAL RESERVE BANKS, TUESDAY, MAY 18, 1920.

Gentlemen, the Board desires me to welcome you to Washington and to express its appreciation of your consideration in leaving your business and coming here to this conference.

We have been very judiciously advised from time to time by the Federal Advisory Council, which body has always held its four statutory meetings a year, and at times its executive committee has come on by request for a special meeting; but the present situation is such that we felt it would be helpful if we could have with us not only the Advisory Council but also the Class "A" Directors of the Federal Reserve Banks. We should have liked to have had all of the Directors, but we could not ask them all to come to Washington at one time, for it is necessary that a quorum of directors be left at home to attend to the business of the Federal Reserve Banks.

The Class "A" Directors are the banker members of the Boards of Directors of Federal Reserve Banks. They have a dual relationship. They are not only directors and, as a rule, very influential directors of Federal Reserve Banks, but they are officials of member banks and thus they see both sides of the picture. So it seems to be peculiarly appropriate, at a time when there is a banking situation to discuss, to have bankers here to discuss it.

As you are busy men it will be our purpose to detain you for as short a time as possible, and if it is agreeable to the members of the Conference, we will try to finish our discussion by half past 1 or 2 o'clock so that you can then be free to take afternoon trains home, if you wish, or to devote your time, if you stay in Washington, to such other engagements as you may have.

Of course, we all realize that the credit position is extended and very considerably extended. There is no occasion, though, to be unduly disturbed over the situation. We want to look at the facts as they are and not deceive ourselves in any particular. Having diagnosed the case, then we want to determine what is the proper policy to pursue. We have had an analysis made of the general banking credit expansion in this country, and without going into details I am going to save time by stating the result.

After allowing for the normal credit expansion in a growing country, we find that since the 30th of June, 1914, the expansion of bank credit in this country has amounted to about eleven billion dollars. At the same time the expansion in the volume of currency in circulation, deducting from our starting point the currency held in the Treasury, and deducting from the present figures the amount held in the Treasury and in the Federal Reserve Banks, has been about one billion, nine hundred million dollars. When we remember that during the last three years the Government has floated twenty six billion dollars of securities to take care of its own war requirements, and to enable it to make advances to governments associated with us in the war, this expansion of bank credit does not seem to be excessive or disturbing, when looked at purely from the standpoint of war necessity; but the situation that we want to discuss particularly today, and which seems

to be disquieting, is the expansion that has taken place in the last twelve or fourteen months. From the 1st of April, 1919, to the 1st of April, 1920, the expansion of bank credit was about 25 per cent. This has been in spite of the very large reduction of the amount of Government obligations outstanding. The reduction in Government obligations has all been absorbed by commercial credits, with the net result of expansion of bank credits of about 25 per cent. During the same time there has been an advance in commodity prices of about 26 per cent. This has been accompanied by a decrease in production of essential articles.

Assuming for the year 1918 an index number of 100 in each of ten principal articles of everyday use and necessity--not necessarily production figures, but distribution and consumption figures, such commodities as grain, live stock, wool, copper, cotton, petroleum, pig iron, steel bars--putting all them at 100 for the year 1918 we get an index number for the year 1919, on the average of the ten commodities, of 89.07. While these figures cannot be accepted as indicating a positive decline in production, they do indicate a decided trend in that direction, a certain trend toward a reduction in the distribution of those products, so to all intents and purposes we may assume that there was a decline in essential production during the year 1919 of about 10 per cent. At the same time credit has expanded 25 per cent.

It is this tendency of production to decline, particularly in some essential lines, which constitutes a very unsatisfactory element in the present outlook. It is evident that the country cannot continue to advance prices and wages, to curtail production, to expand credits and to attempt to enrich itself by non-productive and uneconomic operations without foster-

ing discontent and radicalism, and that such a course, if persisted in, will eventually bring on a real crisis.

There is a world-wide lack of capital, and with calls upon the investment market which cannot be met there is an unprecedented demand for bank credits. The fact must be recognized that however desirable on general principles continued expansion of trade and industry may be, such developments must accommodate themselves to the actual supply of capital and credit available.

Official bank rates now in force in the leading countries are higher than at any time during the present century, except during the war panic week at the beginning of August 1914. Only within the last few weeks the official rate in Italy has been raised from 5 to 5-1/2, the Bank of France rate from 5-1/2 to 6, and the Bank of England rate from 6 to 7 per cent.

Every effort should be made to stimulate necessary production, especially of food products, and to avoid waste. Planting operations in many sections have been delayed because of adverse weather conditions, and should there be an inadequate yield of crops this year the necessity for conservation and conservatism will be accentuated. War waste and war financing result inevitably in diminished supplies of ^{goods} and increased volume of credits.

Now I assume, looking at the matter from the standpoint of the economist that the trouble with the general situation throughout the world, and in this country, is the disruption of the proper proportion or relationship between the volume of credit and the volume of goods. Whenever that phenomenon occurs, there are two remedies which suggest themselves: first a reduction in the volume of credit, credit contraction. That is a drastic

remedy, it is unpleasant medicine, but it may be necessary at times to take medicine of that kind. The other and better method is to restore the proper equilibrium by building up production, in other words, letting the country catch up with itself. We can approximate this result in two ways. We can restrict credit and expand production, letting the expansion of production proceed at a greater rate than the restriction of credit, and we are then working along in the right direction. This is our essential problem today, the formulation of some constructive policy to be adopted by the Federal Reserve Banks which will build up essential production and at the same time preserve the solvency of other concerns which may not be essential per se, but which are highly essential as part of the general situation, because there is no chain which is stronger than its weakest link.

Now, there is undoubtedly, however, a spirit of extravagance in this country which must be curbed. There are some indications that the people are waking up to what the consequences will be if this wild orgy of extravagance and waste should be continued indefinitely. It may be that some real personal sacrifices must be made for the general economic good. But it is very clear that if we find it impossible under the present circumstances to increase the volume of production of the most essential articles, the only thing for us to do is to reduce consumption of those articles.

Now, we might as well look at the situation as it is. A prudent man never lives for the day alone. He always looks to

the morrow and the months to come. What is the situation in regard to the output of the mines and of the farms in particular? What has been done to get normal output and production at the present time and to provide proper means of distribution of the output in order that there may be no acute shortage in the fundamental necessities of life next Winter? In this connection, I might call attention to one circumstance which has caused a good deal of uneasiness. It may not prove as bad upon analysis as it appears at first blush, but I refer to the lack of liquidation which we have experienced during the early months of the present year. We all know that normally, after the fall trade is over and the crops have been harvested and distributed, there is a marked easing of money accompanied by the liquidation of debts. This occurs usually in January and February and up to the middle of March of each year. Liquidation of this kind is entirely natural and is necessary in order that the banks may strengthen their resources in order to meet the demands which will be made upon

them later on in the year as the crops are in the process of making or harvesting. This year we have had no such liquidation. Commercial loans have expanded steadily, and while there has been some reduction up to the last week or so in loans secured by Government obligations, it is noticeable in the last few days that those loans have increased. It would appear that this means an anticipation on the part of the American people for their requirements for bank credit which they usually make later on in the year. We may well inquire that as we have had this demand at a time when we ought to have had liquidation, what is our situation going to be in the later months, when we are going to have the demands which we have been accustomed to having? Now, I hope that the answer to this is -- and if this is correct it is the reassuring feature of the situation -- that the demands which have been made in the past few months, when we should have had liquidation, are due, at least in part, to the fact that essential commodities have been held back by lack of transportation facilities. Then our problem is directed to opening up the transportation facilities in order that these goods may flow to market. This done, we will get some liquidation which ought to be sufficient to offset the demands which will be made upon the banks for essential purposes later on in the year.

But we have figures to show that the extravagant spirit has not yet been checked. There are some indications that the peak has been reached and that people are coming to a more realizing sense of the situation and that they will pursue ^a sounder and a saner course. There ought to be a ^{recrudescence} of our old war-time spirit, of doing something that is worth while, and we should get down to work and solid business. There should be a general spirit of cooperation on the part of the Federal Reserve Banks, the member banks, the non-member banks and the public to work out a policy which will result in greater production, less unnecessary consumption and greater economy; all unnecessary borrowings for the purpose of pleasure and luxury should be restricted as far as possible and the liquidation of long-standing, non-essential loans should proceed.

We should be careful, however, not to overdo this matter of liquidation, because too drastic a policy of deflation, which might result in crowding to the wall and throwing into bankruptcy legitimate enterprises, however unessential their operations may be, would have a tremendously bad effect and would defeat the purpose of the very policy which we are trying to have established. There must always be a wise and discriminating judgment used.

A sensible and gradual liquidation will result in permanent improvement, as we all know, but any attempt at radical or drastic deflation merely for the sake of deflation will result in very serious consequences, and such a policy should be avoided.

It will be helpful for us to discuss and to understand the parts which must be played by the Federal Reserve Board, the Federal Reserve Banks and the member and the nonmember banks in solving the financial and economic problems that confront us.

Our problems are inter-related, but they are distinctive. The Federal Reserve Board is a governmental body, sitting here in Washington. It does not come, except indirectly, in contact with the member banks, and it can not be expected to have any intimate knowledge of the details of your business. And, it ought not to attempt to interfere with the details of your business. The function of the Federal Reserve Board, is to deal with general conditions and principles and to keep away from the mass of details which it is impossible for any Board sitting here in Washington to digest.

The Federal Reserve Banks do come in direct relationship and contact with their member banks. They have an intimate knowledge of the credit policy and of the borrowings of the member banks; they are kept fully informed from day to day of the change of position of the member banks, and through their contact with the Federal Reserve Board, as the coordinating and supervising

body, they keep informed as to the Board's general policy, and they transmit to the Board such specific and general information as may be of assistance in determining these policies. But the primary banking business of this country is transacted by the member and the nonmember banks. Those are the banks which come in contact with the public; which are the custodians of the funds of the public, put with them on deposit, and they are the media through which commercial loans are made.

We have heard a great deal about the necessity of discriminating between an essential and a less-essential and a non-essential loan. The discount operations of the Federal Reserve Banks and their powers to make investments are all clearly defined in Sections 13 and 14 of the Federal Reserve Act. Those sections are permissive and not mandatory. A Federal Reserve Bank is not required to make any particular loan or any particular investment. The Federal Reserve Board may define eligible paper, but all rulings and regulations of the Board must be in strict conformity with the terms of the Federal Reserve Act. The Federal Reserve Board has no legislative powers whatever. It can merely interpret by regulation or rule, the enactment of Congress.

Now, without discussing any power that the Federal Reserve Board may have to define essential and non-essential loans, I wish to point out that Section 13 provides, in a general way, that any paper maturing within the prescribed time, the proceeds of which have been used, or are to be used, for commercial, industrial or agricultural purposes, is eligible. There is no specific condition imposed as to whether or not, in the judgment of any man or body of men, any particular loan is an essential loan, for the well being of the community or the country at large.

The Board has reached the conclusion that there is no occasion now,

of a country-wide application, to define essential and non-essential paper. You remember the difficulties that were experienced in making such a definition during the war, when we had the War Trade Board, the War Industries Board, the Capital Issues Committee, and other temporary Boards here passing upon all these matters. At that time the problem was simpler than it would be now, because there was a general underlying principle that anything essential must be something that was necessary or contributory to the conduct of the war. Now we have no war. The temporary boards have all dissolved and gone. The Federal Reserve Board is not a temporary board. It is a permanent organization and it must conduct its business in strict accordance with the terms of the Federal Reserve Act. Therefore, I think we are all agreed that there is no occasion at the present time, if ever, for the Federal Reserve Board to attempt to define, by regulation of country-wide application, what is an essential and what is a non-essential loan. A Federal Reserve Bank is in much better position to undertake this than is the Federal Reserve Board. But even here there are difficulties in the way. Some of the Federal Reserve Districts cover very large areas. A rule adopted by one Federal Reserve Bank may not be susceptible of adaptation in another Federal Reserve District, because what seems to be essential or necessary in one place may not be in another. While there is no particular objection to a Federal Reserve Bank, in the wisdom of its Directors, ^{its} undertaking to make a general discrimination between loans plainly unnecessary, plainly non-essential, and those which are less essential or more essential, it seems to the Board that that whole question of discrimination might very properly be left for solution at the source, as a matter between the individual banker and his own customer, because the individual banker, particularly at times like the present, has a very close, personal relationship with a borrowing customer. They can talk matters

over with the utmost frankness. The individual banker is in position to give advice. He can accustom his customer to come to him, in advance of seeking a loan, or of making any commitment involved, to discuss the situation with him before the commitment is made. The individual banker in many cases - - of course this may not be possible in the larger cities - - but the great mass of banks all over the country that do mostly a local business can very largely anticipate the legitimate and necessary credit demands.

which are going to be made upon them; they can estimate the fluctuation in the volume of their deposits, and they are better qualified than any one else to give advice to a borrowing customer. They can often restrict the amount of a loan before it is made and can persuade a customer in very many cases that he really does not need the money after all. Then, again, the individual banker can determine, not so much the essential nature of a loan from an elementary standpoint, as to whether the loan is going to produce something that is absolutely needed, but he can decide better than any one else whether the loan is essential or necessary for the public good in his particular locality, not only as a means of producing something that ought to be produced, and which is needed for consumption, but as a means of preserving the solvency of his community. We all know that if the bankers in any community, large or small, were to clamp the screws on tight, they could bring disaster to the community, which might spread to other communities.

Of course, there may be cases, and there have been cases, doubtless, probably in all of the districts, where some of the banks have overdone the matter of extending credits, but there is one very encouraging feature of the present situation, and that is such cases are comparatively few. The majority of all the member banks in each of the Federal Reserve Districts are not borrowers from the Federal Reserve Bank, and the number of member banks which are borrowing from the Federal Reserve Banks in an amount exceeding their ^{own} capital stock is not large in proportion to the total membership. Every banker knows, or he ought to know, what reasonable line of credit he can get from his Federal Reserve Bank, and I want to call your attention to the power that the Directors of the Federal Reserve Banks have to limit their loans. I referred a moment ago to the fact that there is no mandatory provision in the Federal Reserve Act requiring that any particular loan be made. The nearest approach

to compulsion in the matter of loans that you will find anywhere in the Act that provision which permits and, upon the affirmative vote of five members of the Federal Reserve Board, requires a Federal Reserve Bank to rediscount for another Federal Reserve Bank. With this exception there is no other mandatory provision relating to loans in the Federal Reserve Act. While sections 13 and 14 are permissive, there is however, a strict injunction laid upon the directors of the Federal Reserve Banks in that part of section 4 which requires the Directors of a Federal Reserve Bank, to administer its affairs without favor or discrimination for or against any member bank, and in making loans, discounts and advancements which in their opinion may be safely and reasonably made, to pay due regard to the wants and requirements of other member banks. Thus the directors of Federal Reserve Banks are clearly within their rights when they say to any member bank, "You have gone far enough; we are familiar with your condition; you have got more than your share, and we want you to reduce; we cannot let you have any more." They must exercise their discretion as to the proper course to pursue, but they have the power, and there are many cases where the rule ought to be laid down and a member bank ought to be made to understand that it cannot use the resources of the Federal Reserve Banks for its own private advantage for profit; that it must not abuse the rediscount privileges of the Federal Reserve System.

When a banker understands, just as he did in the old days before we had the Federal Reserve Banks that there is a limit to his borrowing -- you will remember in the old days no National Bank was permitted to become indebted for borrowed money in an amount exceeding its capital stock -- when a banker realizes that if he wants to expand his business he must do it more and more out of his own resources and not lean so heavily upon the Federal Reserve Bank, when he understands what limitations and penalties may be imposed upon his borrowings, then I know anything about the psychology of banking I know that the banker may

be depended upon to use a wiser discretion in the matter of granting credit.

The recent amendment to paragraph (d), section 14, which empowers the Federal Reserve Bank, for itself, and without regard to any other Federal Reserve Bank, to establish a normal or basic line of credit upon some principle applicable to all member banks in its District alike, and to impose a graduated or penalty rate upon excessive borrowings, does not repeal, amend or modify in any particular the provisions of section 4 or section 13, and a Federal Reserve Bank is still, even though it adopts the progressive or penalty rate, entirely within its rights in declining to take undesirable paper at any rate. The progressive or penalty rate I will not discuss at this time, because we will have an open discussion a little later on and we will take it up then.

It may be argued that the volume of credit must necessarily be greater now than was the case a few years ago on account of the higher prices and higher wages which are prevailing, so that any given transaction requires a greater number of dollars to finance it than was formerly the case. That is true, but I believe that I can present figures to you that will convince you that if there could be a freer flow of goods and credit, in other words, a greater velocity in the turnover of credit, the resources of the banks of this country are abundantly

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ample to finance all essential enterprises and a good many of the non-essential as well. The fundamental trouble with the situation today is that there is a large volume of essential goods^{and commodities} held back from the markets and kept out of the channels of distribution, either for speculative purposes, being held with the idea of getting higher prices later on, or where they are held back of necessity on account of lack of facilities to transport them to market. In the latter case, it is a wise and proper policy to ease the situation along, to assist the people who are thus compelled to hold and not throw any obstacles in their way, provided there is a genuine and sincere disposition to put the stuff in process of distribution as soon as transportation can be had. But in the case of the hoarder, who for selfish and profiteering purposes wishes to hold back from the mouths of hungry people essential articles of food, or from the backs of the naked essential articles of clothing, every good banker should exert every influence within his power to force people of that kind to turn loose their hoards. Here is an opportunity for wise discrimination, and this discrimination can be exercised more intelligently and effectively by the individual banker himself than by any Governmental board.

We find instances also which always occur when there is a constantly advancing tendency in the market, where merchants have stocked up. There are many cases where mercantile loans are too large and ought to be reduced. There are merchants everywhere who ought to be reasoned with and who ought to be encouraged to push their stocks out and get rid of the high priced stuff, because some of these days, it may be sooner rather than later, the reign of reason is going to be restored and the man in the street is no longer going to want to pay \$25.00 to \$30.00 for a silk shirt, or \$20.00 for a pair of shoes or \$1.00 for four pounds of sugar, ^{and} lower prices will be demanded, and trade will fall off unless lower prices prevail. It seems to me, from the standpoint of good merchandizing and good banking, that the merchants should be encouraged to reduce their stocks and not tempt the passer-by by extravagant display in the windows at high prices, which under the abnormal state of mind which has prevailed, may themselves help to sell the goods, because you all know cases where a customer would pass by with contempt a two or three dollar article and turn his attention to something at \$25.00, although it may not be one whit better suited to his purposes.

In order to bring about a correct tendency and to lead to a permanent cure of our present situation, a campaign of education must be begun and continued. Here, again, there is no agency so well qualified as the banker, who receives on deposit the money of the public and makes loans to the public, to give advice, so thus there should be a concerted effort all over this country on the part of the bankers to arouse in the public a spirit of common sense. Let us take our heads out of the clouds and get down to business, and let us save, produce, and let each do his part in a constructive and productive way for the community, to add to the volume of goods and facilitate distribution, thereby doing something to cure the discrepancy, the bad relationship which has existed between the volume of goods and the volume of credit and money.

In any circumstances, you all know that the Federal Reserve Banks and the Federal Reserve Board will do their part to cooperate with the sound, sensible and reasonable member banks. In order that we may accomplish any real results and effect any permanent good, there must be cooperation on the part of the public with the banks, and on their part with the Federal Reserve Banks and the Federal Reserve Board. We must all pull together for sound, economic and financial principles. We should do all in our power, and we can do a great deal to check the false ideas which have gained circulation and inculcate in the minds of the people a sense of the importance of steady, every-day production and distribution, and to encourage the avoidance of waste and the elimination of

extravagance.

I have here some charts, which will be distributed among you, which show the movement of principal asset and liability items of each Federal Reserve Bank and of the System, of the twelve banks combined. These figures are taken from July 3, 1919, to April 30, 1920. They show the gold reserves, the total cash reserves, the member banks' reserve deposits, the Federal Reserve notes in circulation, the acceptances bought, paper secured by Government war obligations, divided into the headings, secured by Liberty Bonds, secured by Victory Notes, and secured by Treasury Certificates, and the total discounted paper on hand. Then there is another table which shows the volume of bankers' acceptances purchased from other Federal Reserve Banks and the volume of bankers' acceptances sold to other Federal Reserve Banks, figures at the close of business on each Friday from July 3, 1919, to April 30, 1920.

Now, gentlemen, I declare the meeting open for general discussion.

RECOMMENDATIONS OF THE FEDERAL ADVISORY
COUNCIL TO THE FEDERAL RESERVE BOARD

May 18, 1920

Hon. W. P. G. Harding, Governor,
Federal Reserve Board,
Washington, D. C.

My Dear Sir:

The Council has given consideration to the matters included in your communication of April 17th, and beg to reply thereto in the following manner, following the order set out by you:

TOPIC NO. 1.—“Causes of continued expansion of credits and of Federal Reserve note issues.”

Answer:

There are many contributing causes of which the following may be regarded as paramount:

1. We recognize, of course, that the first cause is the Great War.
2. Great extravagance, national, municipal and individual.
3. Inefficiency and indifference of labor, resulting in lessening production.
4. A shortage of transportation facilities, thus preventing the normal movement of commodities.
5. The vicious circle of increasing wages and prices.



TOPIC NO. 2.—“How can the reserve position of the Federal Reserve banks be materially strengthened before the seasonal demand sets in next Fall without undue disturbance of the processes of production and distribution?”

Recommendation:

By urging upon member banks, through the Federal Reserve banks, the wisdom of showing borrowers the necessity of the curtailment of general credits and especially for non-essential uses, as well as continuing to discourage loans for capital and speculative purposes; by checking excessive borrowings through the application of higher rates.



TOPIC NO. 3.—“If steps cannot be taken at this time leading to a more normal proportion between the volume of credits and the volume of goods, when can they be taken?”

Recommendation:

In our opinion steps should be taken now, as outlined in answer to the last question.

TOPIC NO. 4.—“What is the effect upon the general situation of the increased Treasury borrowings and what should be the policy of the Federal Reserve banks in establishing rates of discount on paper secured by certificates of indebtedness?”

Recommendation:

It is obvious that the borrowings of the Treasury have the same effect upon the general credit situation as those of other borrowers. The Council would suggest the wisdom of Congressional relief from the burden of government financing by a policy of rigid economy; the revision of the tax laws for the sake of a more equitable distribution of the burden without reducing the revenue; the enactment of the budget system, the budget to include provision for the gradual payment of the short time obligations of the Treasury. These would of necessity preclude unwise appropriations, such as the proposed soldiers' bonus.

In view of the large volume of Treasury Certificates of Indebtedness carried by member banks at the instance of the Treasury Department, we believe that rates established by the Federal Reserve banks on paper secured by them should not be materially greater than the rates borne by the Certificates.



TOPIC NO. 5.—“Should there be a revision of rates on paper secured by Liberty bonds and Victory notes?”

Recommendation:

From a survey of the present rates in force by the Federal Reserve banks it would seem that six per cent is now being charged on paper secured by Liberty bonds and Victory notes. In the judgment of the Council when and if any further revision of rates should be made there should be shown due consideration for the original subscriber of government securities.

(Signed) JAS. B. FORGAN, President.



The following members of the Federal Advisory Council were present at this meeting: Messrs. James B. Forgan, President; L. L. Rue, Vice-President; Philip Stockton, A. B. Hepburn, W. S. Rowe, J. G. Brown, Oscar Wells, F. O. Watts, E. F. Swinney, R. L. Ball, A. L. Mills, and Merritt H. Grim, Secretary.

FEDERAL ADVISORY COUNCIL.

Continued.

Messrs. F O Watts, J W Bailey, G M Reynolds, R H Truman and E W Decker.

Mr. Puelicher offered the following resolution which was unanimously carried.

RESOLVED: That the bankers here assembled, in their capacity as members of the Federal Advisory Council, in their capacity as directors of the Federal Reserve banks of the capacity; in their capacity as members of the "Orderly Deflation Committee of the American Bankers Association, and in their capacity as officers and directors of banks doing business in the various cities of the country, approve the sentiments expressed in the very able address of Governor Harding as representing the views of the Federal Reserve Board; and also be it

FURTHER RESOLVED: That they believe that the widest publicity should be given the address, and further, that they hereby agree to abide by the spirit of the address, in the conduct of their own affairs, and that they will encourage its general adoption by the bankers and people of our country.

Mr. James B. Fergan as Chairman of the American Bankers' Association Committee on "Orderly and proper deflation of Credits" read to the meeting several letters and telegrams from various organizations, including The National Implement and Vehicle Co., The National Federation of Constructive Industries, The Studebaker Corporation, the General Motors Corporation, protesting against certain industries being classified as non-essential so that they would be discriminated against when applying for bank credit.

It was decided as stated in Governor's address that the Federal Reserve Board and the Federal Reserve banks could make no classification as to essential and non-essential industries and that the member banks individually should be strongly urged to use utmost discretion in granting credits.

Mr. F. O. Watts for the Committee reported the following preamble and resolution on the railroad situation, which on motion was unanimously adopted

by the Conference. One of the country be assisted by the Chairman to present this Resolution to the Interstate Commerce Commission and the United States Shipping Board with such verbal presentation

M. ... for Resolution:

The whole country is suffering from inflation of prices with the consequent inflation of credit. From reports made by the members of this Conference, representing every section of the country, it is obvious that great sums are tied up in products which if marketed would relieve necessity, tend to reduce the price level and relieve the strain on our credit system.

This congestion of freight is found in practically all of the large railroad centers and shipping ports. It arises chiefly from inadequate transportation facilities available at this time and is seriously crippling business. We are informed that the per ton mile of freight increased in three years - 1916, 1917 and 1918 - 47%, while the freight cars in service during the same period increased 1.9%.

A striking necessity exists which can only be relieved through the upbuilding of the credit of the railroads. This must come through the adequate and prompt increase in freight rates. Any delay means the paying of greater cost directly and indirectly and places a burden on the credit system which in the approaching time for seasonal expansion may cause abnormal strain. Even under the load of war inflation, high price level, and extravagances, the bank reserves would probably be sufficient if quick transportation could be assured during the time of the greatest strain.

Therefore Be It Resolved, That this Conference urges as the most important remedies that the Interstate Commerce Commission and the United States Shipping Board give increased rates and adequate facilities such immediate effect as may be warranted under their authority, and that a Committee of five representing the various sections of the country be appointed by the Chairman to represent this Resolution to the Interstate Commerce Commission and the United States Shipping Board with such verbal presentation as may seem appropriate to the Committee.

On motion of Mr. J S Williams the Conference adjourned until 3:30 for lunch.

The undersigned committee appointed to formulate the views
 Governor Harding called the meeting to order and announced the following
 committee to present the resolution adopted by the Conference to the Inter state
 Commerce Commission and the United States Shipping Board as therein provided:
 Messrs. E. W. Decker, C. H. McNider, R L Ball, C E Risman and John Perrin.

On motion of Mr. Puelicher, duly carried, the Governor was authorized to
 appoint a committee of five of which he would be ex-officio a member to draft
 a report to the Federal Reserve Board for publication formulating the views expressed
 by members of the Conference. The following committee was named:

James B. Forgan, John Perrin, Joseph Wayne, Jr., T. P. Beal and R H Treman.

Several other members of the Federal Reserve Board, including Dr. A C Miller,
 H A Moehlenpahn, J S Williams, addressed the conference.

Governor Harding stated that the Committee to draft the statement on the
 work of the Conference would meet after adjournment and prepare it.

The Conference then adjourned, at 5:30 o'clock. Loans with goods
 against which payments of millions of dollars have been loaned,
 the payment being necessarily delayed.

2. Vast quantities of foodstuffs and other goods, against which
 loans have been made, are held for lack of cars and ships, and
 payment of loans consequently deferred.

S E C R E T A R Y.

3. Through loans and purchases, the banks have approximately
 of funds tied up in

\$4,500,000,000 ~~in~~ ~~the~~ ~~form~~ ~~of~~ ~~loans~~ ~~against~~ ~~United~~ ~~States~~

The Committee's report of the work of the Conference is hereto attached and
 Government obligations.
 made a part of these minutes.

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To the Federal Reserve Board:

S i r s:

The undersigned committee appointed to formulate the views expressed by members of the conference May 18, called by you to give consideration to present credit conditions in this country, beg leave to present the following:

At the present time banks have loaned to their customers a total which is beyond all precedent and, in endeavoring to meet their requirements, have called upon Federal Reserve Banks for loans and rediscounts in greater amount than ever before. As a consequence, reserves of Reserve Banks are now reduced almost to the legal minimum, and this at a season when they should be high in preparation for the inevitable expansion of loans in the autumn for crop moving.

Causes contributing to the great increase of loans include the following:

1. Thousands of blockaded freight cars are loaded with goods against which hundreds of millions of dollars have been loaned, the payment being necessarily delayed.
2. Vast quantities of foodstuffs and other goods, against which loans have been made, are held for lack of cars and ships, and payment of loans consequently deferred.
3. Through loans and purchases, the banks have approximately ~~\$4,500,000,000 in outstanding advances against~~ of funds tied up in United States Government obligations.

4. Vast amounts have been loaned to individuals, firms and corporations to pay income and excess profits taxes.

Industry and trade are intensely active. The demand for commodities is beyond our power to supply with the present rate of production. The universal competition to buy has been a vital factor in advancing all prices so that constantly increasing working capital and bank loans have been required to handle the same volume of goods. This is illustrated by the fact that from April 1, 1919, to April 1, 1920, bank loans increased approximately 25 per cent, while production of goods declined ^{not less than} 10 per cent.

There is a shortage of capital. Earnings, which would otherwise be added to capital, are to a large extent now absorbed by income and excess profits taxes. ~~Bank loans are already greatly expanded. It is obviously necessary that~~ The volume of industry and commerce ~~must~~ ^{is} be limited by the amount of capital and credit which are available. If credit is strained too far, disaster

~~Bank loans are already greatly expanded.~~ inevitably results. The immediate problem is to determine a course which will hold the volume of our industry and commerce within the limits for which we have capital and credit, and which will make adequate provision for the inevitable expansion of loans for the Fall crop movement.

During the war extraordinary results were attained by general patriotic cooperation. The present strained credit situation grows naturally out of the war and the subsequent readjustment, and a similar patriotic attitude should now be adopted. It is not merely an ordinary credit regulation which is necessary but a regulation as well of the whole economic situation. Four months of hearty cooperation by bankers, manufacturers, distributors,

producers and consumers, will go far to put the situation right.

Methods of cooperation for the ensuing four months would include the following:

1. Individuals could help by ~~depositing in bank the money~~ deferring purchases of all but received and by carrying in pocket the least possible amount; also absolutely necessary things and consuming the minimum possible; ~~by deferring purchases of all but absolutely necessary things, and by also depositing in bank their money and by carrying in pocket consuming the minimum possible.~~ the least possible amount.
2. Individuals, firms and corporations could help by deferring all but absolutely essential construction, whether of houses, factory extension or other.
3. Those planning issues of securities for new enterprises or expansion of those already existing could help by deferring such issues, thus withholding their competition for capital and credit.
4. States, counties and municipalities could render important aid by deferring the issue of bonds, thus not competing for credit, and by deferring as far as possible all public works and improvements, thus not competing for labor and materials.
5. The Federal Government could defer until after the crop movement all expenditures except those absolutely essential for the orderly conduct of its affairs and could avoid all but absolutely necessary borrowing.
6. If every member bank would reduce the total of its loans by 10 per cent, there would be an aggregate reduction of about \$1,750,000,000. If all of the banks of the country would follow this course, the aggregate reduction would be nearer \$3,000,000,000.

This would give safety to the present credit situation and provide for an equal expansion in the Fall. Indiscriminate deflation is not however desirable. The problem of credit control in the United States is qualitative as well as quantitative. The problem is to regulate the flow and uses of credit so as to bring about a stronger situation with a minimum of disturbance or hardship. Specifically the problem may be stated to be to secure the exercise of greater discrimination in the granting of credit and this is primarily the problem of the Commercial banker. It is within the province of the Federal Reserve Board to supervise the operations of Federal Reserve Banks. Federal Reserve Banks in turn come into closer relations with member banks and may in some measure regulate the volume of their loans. But it is the banker who makes the loans upon whom the responsibility rests to effect a correction of the present situation. The success of his efforts will be measured by the care with which he discriminates in lending so that credit when required for the production of food or other articles of necessary consumption will not be restricted, while new loans for non-essential purposes will be declined and those already made will be gradually reduced. In thus undertaking to regulate loans in order to serve the general welfare, bankers would find it helpful to enlist the sympathetic understanding and cooperation of all, producer and consumer alike. If prompt, intelligent and general cooperation along these lines for four months can be had, capital and credit will be saved and the consumption of goods reduced to such an extent that the situation will be safe.

Respectfully,

James B. Forgan)
 Thomas P. Beal)
 Robert H. Treman) COMMITTEE
 Joseph Wayne, Jr.)
 John Perrin)