MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 18, 1945

The fourth statutory meeting of the Federal Advisory Council for 1945 was convened in Room 336 of the Mayflower Hotel, Washington, D. C., on Sunday, November 18, 1945, at 2:00 P. M., the President, Mr. Brown, in the chair.

Present:

Mr. Charles E. Spencer, Jr.	District No. 1
Mr. S. Sloan Colt (Alternate for Mr. John C. Traphagen)	District No. 2
Mr. William Fulton Kurtz	District No. 3
Mr. John H. McCoy	District No. 4
Mr. Robert V. Fleming	District No. 5
Mr. Keehn W. Berry	District No. 6
Mr. Edward E. Brown	District No. 7
Mr. Ralph C. Gifford	District No. 8
Mr. Julian B. Baird	District No. 9
Mr. A. E. Bradshaw	District No. 10
Mr. Ed H. Winton	District No. 11
Mr. George M. Wallace	District No. 12
Mr. Herbert V. Prochnow	Acting Secretary

Mr. Fleming submitted the following communication which he had sent to the Board of Governors of the Federal Reserve System, Washington, D. C.

"Gentlemen:

"At the meetings of the Federal Advisory Council held on September 16-17, 1945, there was under discussion the question of the licensing of national banks and state member banks of the Federal Reserve System, which licensing formed a part of the machinery for the closing and reopening of the banks as covered by the proclamations of the President of March 6 and 9, 1933, under the Trading with the Enemy Act, and from the Executive Order of March 10, 1933, based upon both the Trading with the Enemy Act and section 4 of the Emergency Banking Act of March 9, 1933.

"Since these proclamations were issued, on December 30, 1933, the President amended the proclamations above stated to exclude from their scope such banking institutions as were not members of the Federal Reserve System. All other banking institutions have, during the long period of years, remained under the license provision.

"The Federal Advisory Council has unanimously adopted the following resolution:

RESOLVED, that the Board of Governors of the Federal Reserve System be requested to use their good offices in having the license provision rescinded, preferably by proclamation of the President in the form that released the nonmember state banks from the license provision, or by such other appropriate measures that will satisfactorily eliminate the license provision.

"The Federal Advisory Council bases this request on the fact that this license provision was part of the machinery for closing and reopening banks during the emergency created at the time of the "bank holiday" in 1933. It will soon be thirteen years since the licensing provision was placed into force. The national banks and state member banks of the Federal Reserve System are all, according to the reports of the various supervising agencies, now in excellent condition.

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"We do not see there is any useful purpose in continuing this emergency provision and as a member of the Federal Advisory Council, representing the Fifth Federal Reserve District, I have been requested by Mr. Edward E. Brown, Chairman of The First National Bank of Chicago and President of the Federal Advisory Council, to present this resolution to you, with the request that you give this request your favorable consideration and endorsement.

Yours very sincerely,

(Signed) ROBERT V. FLEMING,

Member, Federal Advisory Council."

Mr. Fleming advised that the Board of Governors had written a letter to the Secretary of the Treasury strongly recommending that the present licensing of banks be discontinued.

The Council decided to ask the Board of Governors whether there were any further developments regarding the Bill to Reorganize Government Agencies (H. R. 4129) and also whether the Board had prepared a new holding company bill.

The Council then considered at length the following question which had been submitted by the Board of Governors:

"There is increasing discussion of the cost of government debt with special reference to the part of the debt held by banks. What is your opinion as to how best to meet the issues that may be raised?"

The Council also considered the question of ceiling prices on real estate and the relationship of the controls on real estate to inflationary trends.

President Brown suggested that the following three items on the agenda be discussed as a unit:

1. What is the relationship of the wage policy announced by the President and its practical application to our prospects for further serious inflation in our price levels?

2. Does the discussion in government circles indicate that our government has concluded that a rather substantial inflation is desirable? How much and how can the process be stopped?

3. To what extent has the Federal fiscal policy calling for cheap money restricted the influence of the Federal Reserve System's control mechanism?

These questions were considered particularly in their relation to possible inflationary trends.

The meeting adjourned at 5:15 P. M.

HERBERT V. PROCHNOW,

Acting Secretary.

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MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

November 19, 1945

At 10:45 A. M., a joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of the Federal Reserve Building, Washington, D. C.

Present: Members of the Board of Governors of the Federal Reserve System:

Chairman Marriner S. Eccles; Governors John K. McKee, Ernest G. Draper, and R. M. Evans; also Messrs. Elliott Thurston, Assistant to the Chairman; Chester Morrill, Special Adviser to the Board of Governors; also S. R. Carpenter, Secretary of the Board of Governors; also Bray Hammond, Assistant Secretary of the Board of Governors; J. J. Connell, General Assistant, Office of the Secretary; George B. Vest, General Attorney; E. A. Goldenweiser, Economic Adviser, Division of Research and Statistics; Woodlief Thomas, Director, Division of Research and Statistics; Leo H. Paulger, Director, Division of Examinations; Edward L. Smead, Director, Division of Bank Operations; Carl E. Parry, Director, Division of Security Loans; Bonnar Brown, Assistant Director; Robert F. Leonard, Director, Division of Personnel Administration, and Liston P. Bethea, Director, Division of Administrative Services.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. S. Sloan Colt (Alternate for Mr. John C. Traphagen), William Fulton Kurtz, John H. McCoy, Robert V. Fleming, Keehn W. Berry, Ralph C. Gifford, Julian B. Baird, A. E. Bradshaw, Ed H. Winton, George M. Wallace, and Herbert V. Prochnow, Acting Secretary.

President Brown expressed appreciation for the assistance the Board of Governors had given to the effort to terminate the Treasury licensing of banks.

The Chairman of the Board of Governors advised that the Board had no additional information regarding the Bill to Reorganize Government Agencies (H. R. 4129).

The Chairman of the Board of Governors stated that he had sent a proposal to the Treasury and to the Attorney General for them to consider regarding holding companies, but the proposal at present was only on a staff level.

There was a lengthy discussion on the following question which had been submitted by the Board of Governors:

"There is increasing discussion of the cost of government debt with special reference to the part of the debt held by banks. What is your opinion as to how best to meet the issues that may be raised?"

A discussion then took place on the following subjects: ceiling prices on real estate; wage policies in relation to inflation; federal fiscal policies and their relationship to inflation.

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The Chairman of the Board of Governors commented briefly on the thirty per cent rule in connection with war loan deposits, the government policy regarding Treasury balances and the authority of the Federal Reserve System to purchase government securities directly from the Treasury.

The meeting adjourned at 1:08 P. M.

HERBERT V. PROCHNOW,
Acting Secretary.

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November 19, 1945

At 2:08 P. M., the Council reconvened in the Board Room of the Federal Reserve Building to hear Dr. Goldenweiser, Economic Adviser, Division of Research and Statistics of the Federal Reserve System.

Present: Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. S. Sloan Colt (Alternate for Mr. John C. Traphagen), William Fulton Kurtz, John H. McCoy, Robert V. Fleming, Keehn W. Berry, Ralph C. Gifford, Julian B. Baird, A. E. Bradshaw, Ed H. Winton, George M. Wallace, and Herbert V. Prochnow, Acting Secretary.

Dr. Goldenweiser gave an account of his recent visit to a number of European countries and of his discussions with the officials of some of the European central banks. Dr. Goldenweiser also gave briefly his impression of inflationary developments in this country.

The meeting adjourned at 3:50 P. M.

HERBERT V. PROCHNOW,
Acting Secretary.

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NOTE: This transcript of the Acting Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript should be considered as being strictly for the sole use of the members of the Federal Advisory Council.

H. V. P.

Acting Secretary's notes on meeting of the Federal Advisory Council on November 18, 1945, at 2:00 P. M. in Room 336 of the Mayflower Hotel, Washington, D. C.

All members of the Federal Advisory Council were present except that Mr. S. Sloan Colt served as alternate for Mr. John C. Traphagen.

TREASURY LICENSING OF BANKS

Brown asks Fleming to report on the Treasury licensing of banks and also on the bill for the reorganization of government agencies.

Fleming states that he has written the following communication to the Board of Governors.

October 22, 1945

The Board of Governors
of the Federal Reserve System
Washington, D. C.

Gentlemen:

At the meetings of the Federal Advisory Council held on September 16-17, 1945, there was under discussion the question of the licensing of national banks and state member banks of the Federal Reserve System, which licensing formed a part of the machinery for the closing and reopening of the banks as covered by the proclamations of the President of March 6 and 9, 1933, under the Trading with the Enemy Act, and from the Executive Order of March 10, 1933, based upon both the Trading with the Enemy Act and section 4 of the Emergency Banking Act of March 9, 1933.

Since these proclamations were issued, on December 30, 1933 the President amended the proclamations above stated to exclude from their scope such banking institutions as were not members of the Federal Reserve System. All other banking institutions have, during the long period of years, remained under the license provision.

The Federal Advisory Council has unanimously adopted the following resolution:

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RESOLVED, that the Board of Governors of the Federal Reserve System be requested to use their good offices in having the license provision rescinded, preferably by proclamation of the President in the form that released the non-member state banks from the license provision, or by such other appropriate measures that will satisfactorily eliminate the license provision.

The Federal Advisory Council bases this request on the fact that this license provision was part of the machinery for closing and reopening banks during the emergency created at the time of the "bank holiday" in 1933. It will soon be thirteen years since the licensing provision was placed into force. The national banks and state member banks of the Federal Reserve System are all, according to the reports of the various supervising agencies, now in excellent condition.

We do not see that there is any useful purpose in continuing this emergency provision and as a member of the Federal Advisory Council, representing the Fifth Federal Reserve District, I have been requested by Mr. Edward E. Brown, Chairman of The First National Bank of Chicago and President of the Federal Advisory Council, to present this resolution to you, with the request that you give this request your favorable consideration and endorsement.

Yours very sincerely,

(Signed) Robert V. Fleming
Member, Federal Advisory Council

Following the receipt of Fleming's letter, the Board of Governors wrote a strong letter to the Secretary of the Treasury recommending that the licensing be discontinued. The American Bankers Association and the Reserve City Bankers Association also wrote letters to the Secretary of the Treasury requesting the termination of the licensing requirement. The matter is now under consideration and it is anticipated the Secretary of the Treasury will recommend to the President that action be taken ending the licensing requirement.

REORGANIZATION OF GOVERNMENT AGENCIES

Fleming reports that he saw John Snyder and was assured by him that all those interested would have a chance to be heard in the event the agencies relating to banking are reorganized. Snyder also indicated that Eccles would not necessarily have his way regarding any reorganization. He emphasized that his own personal interest in banking would assure adequate and full consideration for any proposals for reorganizing the banking agencies.

Gifford quotes from a comment of Snyder's, reported on page three of Special Bulletin No. 9 of The Small Business Committee of the United States Senate, in which Snyder seems to express ideas not

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wholly unlike those of Eccles.

Fleming believes that in view of Snyder's comments to him, as well as the opinions expressed by others, it would not be advisable for the bankers, including the American Bankers Association, the Reserve City Bankers, and other banking groups, to oppose this bill in Congress; it would have the wrong effect. Moreover, it is probably impossible to stop the bill in Congress anyway. It would be much more advisable to sit around the table with Vinson and Snyder later and work out any reorganization proposals that might be related to the banking agencies.

Brown states that Bell said Snyder would have much to say about any reorganization. The opinion of the Council appears to be unanimous that it is not desirable to oppose the reorganization bill in Congress. Brown will express appreciation to the Board of Governors for the assistance of the Board on the matter of the Treasury licensing of banks and will also ask the Board if there are any new developments on the reorganization bill. In addition, he will advise the Board that the Council will not oppose the reorganization bill in Congress.

HOLDING COMPANY BILL

Brown states that at the meeting with the Board of Governors tomorrow he will report that the Council has been informed that the Board has prepared a new holding company bill, and he will ask if the Board would care to give the Council a copy of the bill. The Council is in favor of Brown's requesting a copy of the bill from the Board.

COST OF THE GOVERNMENT DEBT HELD BY BANKS

Brown asks for discussion on the following question submitted by the Board of Governors:

> "There is increasing discussion of the cost of government debt with special reference to the part of the debt held by banks. What is your opinion as to how best to meet the issues that may be raised?"

Fleming suggests asking the Board for a forecast on bank earnings covering five or ten years. This forecast should include possible wage increases and all factors that relate to bank earnings.

Kurtz. Any survey should show the decrease in bank earnings that is taking place as the rates on government securities decline. There is a steady decline in the rates as new issues replace old ones.

Baird. The average term of governments is about four years and we are witnessing declining maturities with declining rates.

Colt understands Patman has figures on past earnings which include items like recoveries. He agrees we should have a complete

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breakdown of past earnings. In recent years, due to government regulations, we have not been able to increase wages as we may in the years immediately ahead.

Brown. There has been some discussion on not making certain future issues eligible for bank investment until they reach their call date. This would force lower rate issues into the banks.

Fleming. In the near future it does not look as if there would be much attractive government paper for the banks.

Wallace believes it would be unwise policy to take any steps which would result in any reduction in bank earnings now if the banking system is to be kept sound.

Brown. Insurance companies have sold many tax exempts and probably will sell others as they become eligible for bank investment.

Colt doubts whether insurance companies will be so anxious to sell.

Brown. Apparently all members of the Council are in favor of having a forecast made of bank earnings. Brown would favor having some group other than the Board of Governors prepare the figures because at least some of the Board members believe bank earnings are too high. He asks how serious Patman is on the whole subject of bank earnings.

Fleming believes Patman is very serious.

Brown. There are various rumors that Patman has bills regarding bank earnings.

Fleming suggests having Dr. Thomas prepare the earning figures.

Kurtz points out that interest rates on various types of assets are declining. He suggests that Dr. Thomas could take samples from various banks to show the types of earning assets, the trends in rates and yields, and the costs of doing business.

McCoy believes the Council should get the Board's figures as well as prepare figures of its own.

Brown states that if endowed institutions are to be kept alive securities must be issued which are not eligible for banks. We have reached a period when issues for these institutions must not be made eligible for banks.

Kurtz calls attention to the action in England where rates were reduced.

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Brown reports that the smaller outlying banks in the Chicago area are earning 20 per cent or more on their capital.

Kurtz believes some independent agency, as well as the American Bankers Association, should prepare earning studies.

Gifford suggests asking Eccles what Patman's bill covers.

Baird agrees.

Berry. The whole trend seems to be to force rates lower and lower and securities out of the hands of institutions. This movement is closely related to that of inflation. (Fleming left at 4:00 o'clock).

Brown. It might be advisable for the Board of Governors to prepare earning figures and give them to the American Bankers Association and possibly to an independent agency for further study. These figures will probably show that earnings will come down rapidly. It is necessary to consider also whether deficit financing is to continue and whether the debt is to be kept in the hands of insurance companies and other institutions. The first essential is to know what the facts are regarding earnings; this includes not only past earnings but also a forecast of the years immediately ahead. Borwn believes the Council should ask the Board specifically what is meant by "the issues that may be raised". To what issues does the Board refer?

Kurtz. Bank earnings are an insignificant factor in our total economy. We need strong banks with good earnings.

Berry. The Board may not even have Patman in mind, but may have in mind general fiscal policy.

CEILING PRICES ON REAL ESTATE

Brown asks McCoy to comment on the question.

McCoy thinks the whole policy of ceilings is wrong as it reduces the earnings on real estate to an inadequate amount. He would be inclined to eliminate the OPA.

Kurtz believes there is another side to the question. The returning veterans are unable to find places in which to live. These men cannot pay any price.

Brown. The problem involves not only ceiling prices on sales but also on new construction. There is a reluctance to build new apartments with existing ceilings.

McCoy favors removing the regulations and thinks that although rents may be higher for a time, new construction will eventually force rents down.

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Brown. Eccles wanted a bill taxing all profits on real estate. Brown talked with Fahey on this whole subject and Fahey is opposed to any government control over the percentage that may be loaned on real estate. Fahey can give many illustrations where loans are being made by savings and loan associations for 120 per cent of the value. Brown states that if you ever get a situation where all appraisals are subject to some Federal control you have advanced a long way to socialism. Mutual savings banks are anxious to cooperate in holding down excessive loans and the same holds true of insurance companies. Stronger action is needed against some of the savings and loan associations, and it might be helpful if one or two small associations of this kind were strongly criticized for their lax lending policies.

Wallace. In California, banks cannot get real estate loans and the FHA handles itself well. He wonders whether this question is a proper one for the Council to consider.

Brown. Eccles would like control over all lending.

McCoy. The whole objective is to get some building construction started. Consequently, he prefers removing the regulations in order to stimulate building.

Brown believes that might not be advisable. People will pay any price for a house and you may have an inflated price structure and a real estate boom. It might be better to take two or three years to work out the situation rather than to remove all regulations at once. Brown doubts whether you can do away with the housing shortage by eliminating all regulations, especially when there are shortages in plumbing fixtures and other articles necessary to construction.

Baird. In the Twin Cities the worry is that they will over-build in two or three years.

Winton reports serious housing shortages in Fort Worth now, but he thinks that in five years there will be many empty houses.

Baird. A small margin one way may make a great shortage and a small margin the other way may make a great surplus.

Brown points out that there are a number of questions related to this problem. Does the Council wish to set ceilings on sales, on new construction? Does it wish control of rents and other controls such as ceilings on prices of plumbing fixtures and construction supplies? Does it wish more of the selective type of controls?

Berry. The question is one of whether the controls are to be removed and what the effects will be on the inflationary trend.

Colt states he personally favors no controls, but if you take off Federal controls in New York, you will have local controls. From the practical standpoint, he believes that controls should be gradually

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relaxed.

Winton favors removal of controls.

Brown is in favor of the removal of all controls but is not certain that public sentiment is such that the net result eventually might not be worse than present government controls. Brown asks the Council's opinion on several questions related to this problem. All members of the Council but one were opposed to controls on the sale of real estate. All members but two favored controls on rent for the present. All members of the Council were opposed to giving any government agency the right to control the appraisal and valuation of real estate, and all members were opposed to the Bowles bill.

WAGE POLICIES AND OTHER FACTORS RELATED TO INFLATIONARY TRENDS.

Brown suggests that the following three items on the agenda be discussed at the same time as they are related:

1. What is the relationship of the wage policy announced by the President and its practical application to our prospects for further serious inflation in our price levels?

2. Does the discussion in government circles indicate that our government has concluded that a rather substantial inflation is desirable? How much and how can the process be stopped?

3. To what extent has the Federal fiscal policy calling for cheap money restricted the influence of the Federal Reserve System's control mechanism?

Berry believes many actions of the government, such as the wage policy announced by the President, may accentuate the inflationary trends.

Brown While the war was going on, it was confidently believed by various individuals in the administration that a controlled inflation of perhaps five per cent a year would encourage maximum production. With the full employment bill and other activities of the government now, it seems that the same idea may be continuing because the same groups seem to be in control.

Berry. When the five per cent idea prevailed, we had controls. Now the controls are in a large measure removed or in process of being eliminated. The monetary policy seems to be toward inflation with a possible econ mic crash at the end.

Brown. If the country goes through another 1921 or a severe depression, he wonders whether our people will stand for it and what political structure will result.

Colt believes that the economic structure is being built along

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the general lines Berry indicates.

Brown. Inflation is hard on the saver and salary earner, but one tends to adjust himself to gradual inflation. Doubling of the price structure will lessen the burden of debt, but it will be hard on savers, holders of insurance policies, and others in similar categories, and Brown doubts whether the political temper of our people is such that they will willingly accept a depression and readjustment.

Kurtz. The productive capacity of the country can take care of great demands. If we sit tight and let the controls remain for a time the situation will tend to adjust itself.

Berry believes Brown's comments on the situation are correct, but thinks the administration is doing things which will speed up inflation.

Winton. The situation will be dominated by political objectives.

Brown. The top labor leaders are opposed to the substantial wage increases now being demanded, but in order to hold their jobs they have had to work for these wage demands. However, we can urge the Board of Governors to use its influence to control the inflationary factors to the greatest extent possible.

Berry. These questions were submitted to help give the Board direction in its thinking, and the benefit of the Council's judgment.

Brown. Two factors are primarily responsible at present for holding back production in the Middle West: (1) wage demands and strikes; and (2) the inefficiency of the OPA. Brown understands that as few as 35 persons can form a picket line and close any General Motors plant in the United States. So long as the government thinks that to offend labor is to lose votes, the problem of production will continue.

Baird is under the impression that the CIO fostered the strikes and was in advance of the other labor groups in promoting strikes.

Brown believes the position of the labor leaders is along the lines of what he has outlined.

Kurtz mentions the slowdowns in Akron and states that he has been informed experienced men there are turning out less than new employees in other areas.

Brown understands certain colleges and universities have sold their stocks.

Baird presumes some selling is based on the fact that some institutions have more or less fixed percentages for the amounts they wish to invest in common stocks, preferred stocks, and bonds.

The meeting adjourned at 5:15 P. M.

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On November 19, 1945, at 10:45 A. M., the Council held a joint meeting with the Board of Governors of the Federal Reserve System in the Board Room of the Federal Reserve Building.

All members of the Council were present except that Mr. S. Sloan Colt represented Mr. John C. Traphagen. The following members of the Board of Governors were present: Chairman Eccles; Governors McKee, Draper, and Evans; also, Messrs. Thurston, Morrill, Carpenter, Hammond, Connell, Vest, Goldenweiser, Thomas, Paulger, Smead, Parry, Brown, Leonard, and Bethea.

TREASURY LICENSING OF BANKS

Brown expresses appreciation for the assistance the Board has given to the effort to terminate the Treasury licensing of banks.

Eccles states he saw Delano, who had talked with Vinson, and that Vinson expects the request for the termination of the licensing requirement to be approved.

Fleming. The letter of Chairman Eccles was strong and most helpful.

BILL TO REORGANIZE GOVERNMENT AGENCIES

Brown asks whether the Board has any further information about the progress of the bill to reorganize government agencies.

Eccles advises the Board has no more information.

McKee reports that there are some who believe the bill has been mutilated by too many exceptions.

Eccles believes the President will veto the measure if by restrictions and in other ways his power to reorganize government agencies is curbed.

HOLDING COMPANY BILL

Brown states that the council understands the Board has withdrawn its holding company bill.

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Eccles replies that the bill has not been withdrawn. He has asked for the opportunity to rewrite it into a more acceptable form, as he believes the Treasury would have opposed the bill. Eccles states there have been some conferences with the Treasury and with the Attorney General, the latter being interested in the monopolistic angle. Eccles hopes a bill may be drawn which will meet with the approval not only of the Board of Governors but also of the Treasury and the Attorney General. A bill with these three groups back of it would have a chance to be passed by Congress. Eccles has sent a proposal to the Treasury and the Attorney General for them to consider, but the proposal at present is only on a staff level. It is not possible now to say what may come out of this proposal.

Wallace asks whether the first holding company bill actually has been withdrawn.

Eccles replies that the first bill has not been withdrawn, but that work is going ahead on the new proposal.

Brown. The Council wishes to know whether it may see a draft of the new proposed holding company bill or be advised regarding its provisions.

Eccles says that this would not be advisable until members of Congress have had an opportunity to see it.

McKee states that the Administration previously had favored the death sentence, but that the majority of the Board of Governors had never favored the death sentence, as it would have been a calamity to some sections of the country. The Independent Bankers Association was anxious to have hearings on this matter and that Association was prepared to support the so-called "freezing bill", that is, the first holding company bill and the one the Board itself supported. He states that the Treasury reserved the right to testify on the first bill, and that the Board has no specific knowledge of whether the Treasury would be for or against that bill. He says that any reference to the first bill being withdrawn can only be conversation. If the first bill is withdrawn, he is certain the Independent Bankers Association will favor the death sentence. McKee emphasizes that if the first bill is now to be changed, or if it is to be withdrawn, a death sentence provision will become a certainty.

Wallace. If the second bill, that is, the new proposal, comes up, will it result in a death sentence?

McKee. I believe so.

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Eccles. The chances of getting any bill are doubtful, and the first bill does not have a chance.

McKee. That is your opinion.

Eccles. With the opposition to the present bill in the Treasury, and with other opposition, Eccles is confident the President would veto the measure. The new bill need not provide for a death sentence or even for freezing, but it can provide for a modified form of control.

McKee states that he may be wrong in his appraisal of the situation, but he believes the Independent Bankers Association has been very active on this matter.

COST OF GOVERNMENT DEBT HELD BY BANKS

Brown reads the following question which has been proposed for discussion by the Board:

> There is increasing discussion of the cost of government debt with special reference to the part of the debt held by banks. What is your opinion as to how best to meet the issues that may be raised?

Brown asks what is meant by the words "to meet the issues that may be raised". The Council would like specific information as to what the issues are to which the Board refers. The Council is not familiar with possible legislation that Patman may have in mind. It is suggested that the Board make a comprehensive study of bank earnings not only for the immediate past, but also a forecast for at least five years ahead. The members of the Council feel that the expenses of banks will be higher and that, as the Treasury refunds government obligations in the form of short-term, low-rate paper, the income of banks will decline. It is true that in the next two years or so certain issues will become eligible for bank investment, but the prices of these issues have gone up and the yields, consequently, have declined. There is at present also no prospect of any substantial demand for funds on the part of private borrowers. The 1-1/2 per cent rate which was originally meant for only the best concerns is now going to second or third rate credit risks. Term loan rates are also low. Brown suggests that an earnings study by the Board might be more acceptable to the government than an earnings survey by the American Bankers Association or the Brookings Institution.

Thomas reports that they are working on a survey which will include possible rising costs of bank operation and also possible lower costs resulting from the installation of more mechanical equipment in banks.

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McKee. In any survey it is necessary to consider possible shifts in deposits which may take place and the situation in different classes of banks.

Fleming mentions that special consideration should be given to recoveries, which are not recurring items.

Thomas. There is the additional question of how banks carry their bond accounts and write off their premiums.

Brown. Is Patman considering any legislation on this subject?

Eccles states that he knows of no legislation, but he believes Patman is making a complete study of the cost of the entire government debt, the cost of the government debt held by the banks, the earnings of banks, and related questions. He would assume Patman would have hearings on the subject before any bill is introduced. The problem is one of the effect the public debt has on the whole economic structure and not merely on bank earnings. The public debt is still going up, whereas private credit is declining. Eccles points out that in 1929 the total private credit outstanding was $169 billions, whereas now it stands at $123 billions. The public debt in 1929 was $18 billions and at the end of the present bond drive will be about $275 billions. In 1929, approximately 10 cents out of every dollar of debt was public debt and 90 cents was private debt. Now the situation is largely reversed. The public debt, therefore, and not private credit, will control the interest rates. So far as credit is concerned, we now have socialism. The banks are forcing the rates down. The rates on government obligations are too high in relation to rates on private paper.

Brown. Are banks or insurance companies forcing down rates?

Eccles. Banks are buying all the securities that are eligible to them and are forcing down the rates. It is too bad that the part of the government debt financed by the banks was not originally placed in an entirely separate category. By eliminating the excess profit tax, private credit will vanish and public credit will take its place. If corporations had had to borrow and pay taxes, it would have been better than to have more government borrowing.

Fleming. The idea of eliminating excess profit taxes came from the government.

Eccles. Vinson was sold the idea by business groups and others, who maintained that it was the best way to get production.

McKee. Will corporations liquidate their government holdings in advance of need?

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Brown. To obtain the funds to pay off their bonds, corporations will liquidate their certificates. This process is going on now. Companies will dispose of the certificates they own and use the proceeds to pay off their bonds held by insurance companies.

McKee. My question is whether companies will sell their government holdings in advance of need.

Brown. Companies will hold to get the 7/8 per cent yield until they need the funds.

Fleming. To the extent that corporations need the funds, companies will liquidate their certificates and the banks will acquire more of the government debt.

Brown. If the government should issue bonds for refunding, not eligible to banks, and would sell them to insurance companies and to institutions handling endowment funds, it would be helpful. It would be desirable economically, but there might be some question as to whether it was politically possible.

Eccles. It is unfortunate that bond drives were conducted so bond issues moved through the back doors of non-bank buyers into the banks. There was too much emphasis on over-subscribing issues. Eccles believes there will be great difficulty in keeping the long term rate at 2-1/2 per cent. The banks have forced down the intermediate rate, so there is now a downward pressure on the long term rate.

Brown. It is unfortunate that the selling organization has seemed to dominate Treasury financing. To return to the original question, if an investigation of bank earnings is intended to get the facts, the Council has no objection to the proper presentation of honest and complete facts.

McKee. A study will take considerable time.

Thomas expects to have a study completed by January 1946 or early in 1946. He says that they have all the facts available to them in the reports that come to the Board.

Eccles. It is not necessary to get more facts. We have the facts but it is,in part at least, a question of interpretation of the facts. There are facts on both sides of the question. Eccles doubts whether any investigation by a member of Congress will be really objective.

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McKee. This job can be done best by country bankers. He emphasizes that the maintenance of a hazardous business like banking requires that banks be permitted to have adequate earnings.

Gifford. Where will Patman get his data?

Eccles. Patman can call on various sources such as the Board of Governors, the Federal Deposit Insurance Corporation, labor economists, the Treasury, and many others.

McKee states he would be inclined to be on Patman's side if the profits in banks run the way they do in some cooperatives.

Eccles. There is probably not so much we can do now except to be prepared with the facts and possibly to be ready to face some readjustment.

McKee. One of the essentials in this whole problem is the necessity of cutting the expenses of government.

Eccles. The expenses of the government can be broken down into simple figures such as the following:

Interest on the public debt	$5 billion
Veterans	5 billion
Army and Navy	10 billion
Public requirements such as roads flood control, etc.	2 billion

Here are only four items totaling $22 billion. There is little place to cut on any of the items. What is essential, however, is to keep taxes up in order to meet these expenses and balance the budget.

CEILING PRICES ON REAL ESTATE

Brown. The Council would appreciate the opinions of the Board on present real estate problems and would be interested to know whether the Board has any program in connection with these problems. He is certain the Board appreciates the seriousness of the situation. Brown reports that all but one member of the Council is opposed to ceilings on real estate sales. All but two members of the Council favor retaining at present the controls on rent. No member of the Council favors the establishment of an agency to control the appraisal and valuation of real estate, and all members of the Council are opposed to the Bowles bill.

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Eccles. The Board was appalled at the WPB abandonment of L 41 and other regulations relating to real estate. The WPB believed that by getting rid of controls, construction would get under way. Eccles believes it is too late to remedy the situation, with all the controls now essentially removed. We shall probably have black markets in building materials. Bowles may try to control lumber prices, but it looks hopeless.

McKee. Does the Council believe L 41 could be brought back?

Brown does not believe it is possible, but would welcome the opinion of the Council members.

Kurtz does not blame the veterans for criticizing the housing situation.

Eccles. The development of a sound building program might be helped by providing for the official appraisal of property. The simple facts are that we eliminated the controls on real estate too soon.

WAR POLICIES AND OTHER FACTORS RELATED TO INFLATIONARY TRENDS

Brown suggests that the following three items on the agenda be considered at the same time because they are closely related.

1. What is the relationship of the wage policy announced by the President and its practical application to our prospects for further serious inflation in our price levels?

2. Does the discussion in government circles indicate that our Government has concluded that a rather substantial inflation is desirable? How much and how can the process be stopped?

3. To what extent has the Federal fiscal policy calling for cheap money restricted the influence of the Federal Reserve System's control mechanism?

Brown asks whether there is any possibility of holding back the inflationary trends as evidenced by wage policies.

Eccles replies that the chance was lost when the excess profit tax was eliminated.

Brown understands that production can be stopped by a relatively small number of men forming a picket line outside a plant, and that no authorities intervene.

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McKee. Can you stop this practice without legislation?

Brown. Unless labor goes too far, there may be no legislation.

Eccles believes there is a definite possibility of legislation because labor may go too far. Labor leaders may take the situation in hand before it goes too far, but at the moment it does not look that way. There is no evidence that the stock market has reached its peak. Houses and business properties are selling on a speculative basis like stocks. We should have an adequate capital gains tax.

Spencer. This situation developed in part because of attempts to save taxes. For example, buildings were sold at a loss to save taxes, and this procedure began a long time ago.

Brown. The movement from war to reconversion proceeded at the beginning even faster than many had anticipated. There is plenty of capital available, but there are now two major difficulties: (1) labor: and (2) the delay by the OPA in fixing prices so companies will know the basis upon which they may proceed. Some large printing press concerns have shut down until they know whether they can charge a price which will enable them to operate at a profit.

Eccles. The elimination of the excess profit tax has worked most unfortunately in the lumber industry. The lumber companies made large profits and now they are unwilling to produce until the beginning of the new year.

Brown. That is a matter of only six weeks.

Eccles believes it is too late now to correct the situation. He emphasizes that we eliminated our controls too rapidly. The price we shall now have to pay is inflation. For three or four years during the war we had controls and held things well in line, and then unfortunately right at the end of the war we threw away our chance to avoid inflation because we eliminated the necessary economic controls.

Berry thinks the government has introduced policies such as its attitude on wages and its fiscal policies which will promote the inflationary trend. He believes steps should be taken to move the government debt out of the banks into private hands. He does not think that increased production, which means a proportionate increase in current income, necessarily stops inflation. Production creates the income with which to buy that production and does not eliminate the large volume of liquid funds already available to buy goods.

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Colt. With the stage set for inflation, how long will it take the productive capacity of the country to catch up with inflation.

Eccles. If the line had been held by the retention of the controls, it would have been possible to meet the problem of inflation. In certain lines like food, the supply is more nearly adequate to our needs, but in automobiles and furniture, for example, conditions are far different. The world generally is in great need of our goods. As a whole, the world has $20 billions to spend for goods here. Mexico alone probably has $400 to $500 million. Consequently, there is a world pressure on our goods, and even our foods, such as oils and fats, would be very short if we gave foreign countries what they wanted; this holds true also of clothing.

McKee points out that Guatemala has more gold earmarked than she has outstanding currency. He stresses the war is over, and our boys are no longer being killed. The future may look foggy and the price the nation may have to pay for inflation is great. However, in return for the price we may pay for inflation, there is one great benefit, and that is that we shall have learned that a government cannot manage an economy.

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The discussion of items on the agenda was completed at this point, but before adjournment the following informal comments were made regarding several matters.

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WAR LOAN DEPOSITS

McKee states he would like to answer a question which Kurtz had asked him some time before the meeting regarding the 30 per cent rule on deposits. McKee has discussed this matter with the Treasury and is of the opinion that if and when the 30 per cent figure is exceeded in a number of cases the Treasury will probably reconsider the rule.

Eccles would not favor changing the 30 per cent rule.

Brown thinks the 30 per cent rule is a good one.

Eccles wishes the Council would pass a resolution urging that the 30 per cent rule be maintained.

TREASURY WORKING BALANCES

Wallace asks whether the Treasury has any future policy regarding its working balances.

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Eccles. After this drive the Treasury probably will permit its balances to decline. Morgenthau believed in large balances. However, the larger the Treasury balances, the more interest that must be paid.

AUTHORITY TO PURCHASE SECURITIES

Eccles. The Board believes the authority of the Federal Reserve System to buy up to $5 billions of securities directly from the Treasury should be made a permanent power of the Board. The Board has never purchased securities directly except to take care of an overdraft.

The meeting adjourned at 1:08 P. M.

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The Council reconvened in the Board Room of the Federal Reserve Building at 2:08 P. M. on November 19, 1945, to hear Dr. Goldenweiser, Economic Adviser, Division of Research and Statistics of the Federal Reserve System.

All members of the Council were present except that Mr. S. Sloan Colt represented Mr. John C. Traphagen.

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No minutes of Dr. Goldenweiser's comments are recorded in view ofthe fact that he distributed mimeographed copies of an article entitled "Statement of E. A. Goldenweiser, Economic Adviser, Division of Research and Statistics of the Board of Governors of the Federal Reserve System, with respect to his visit to European Central Banks", an extra copy of which is attached. Dr. Goldenweiser will also send to each member of the Council a copy of a 39 page article "Conversations and Reflections in Europe, Summer 1945". These two articles not only cover Dr. Goldenweiser's remarks, but also give substantial additional material which time did not permit him to present.

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<u>Brown</u> asks Goldenweiser his impression of inflationary developments in this country.

<u>Goldenweiser</u> believes we shall have an inflationary trend but that it will not get out of hand. A rise in real estate values undoubtedly will take place, but with government expenditures going down we should escape a disastrous inflation. To produce peace-time goods to the amount of our war production will require a 40 to 50 per cent raise in our standard of living. He calls an out-of-hand inflation one in which prices go up 50 per cent or more in one year. He believes we may have perhaps a 10 to 15 per cent rise in a year.

<u>Brown</u> states there was a belief in some government agencies during the war that an inflation in prices of 5 per cent a year would create the maximum production. He asks whether that same type of thinking is prevalent now in government circles.

<u>Goldenweiser</u> believes the government personnel has changed sufficiently to eliminate that type of thinking, and that both in the Treasury and White House the thinking is not along those lines.

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Colt. If our great productive capacity is not brought into effect in the near future, can we hold the inflationary trend to an advance of only 15 per cent in a year?

Goldenweiser. Probably the most important problem facing us today is the one of getting production started so that inflation may be retarded; the other major factor that combats inflation is personal insecurity.

Brown believes we must do all we can to hold down inflationary influences. Labor problems and the inefficiency of the OPA have held back production.

Goldenweiser. We have relaxed the controls too rapidly. (Before leaving he announced that this would be his last appearance before the Council.)

Brown says that on behalf of the Council he expresses appreciation for Dr. Goldenweiser's helpfulness in the past and extends to him good wishes for the future. (Goldenweiser leaves at 3:38 P. M.

STUDY ON BANK EARNINGS

Kurtz suggests that the National Bureau may be the agency which should make the study on bank earnings along the lines discussed by the Council in its meeting on November 18, 1945.

Brown thinks perhaps the American Bankers Association should finance the project.

Baird doubts whether the National Bureau is in the best position to make this study as undoubtedly they would wish considerable time.

Fleming says there are one or two men in the American Bankers Association office who might make the study.

Brown believes it might be best to take up the matter with Dr. Stonier. He says the Brookings Institution is even slower than the than the National Bureau.

Kurtz thinks the last four or five years will show high earnings.

Brown believes the earnings in recent years will be shown to be high. However, the forecasts of future earnings, which will reflect increasing costs, may materially affect the high earning trend of recent years.

WAR LOAN DEPOSITS

Brown asks for the opinion of the Council regarding the suggestion of Eccles that the Council pass a resolution recommending to the Treasury that the 30 per cent rule be not changed. He

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