MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 16, 1947

The fourth statutory meeting of the Federal Advisory Council for 1947 was convened in Room 270 of the Mayflower Hotel, Washington, D.C., on Sunday, November 16, 1947, at 2:00 P.M., the President, Mr. Brown, in the Chair.

Present:

Mr. Charles E. Spencer, Jr.	District No. 1
Mr. W. Randolph Burgess	District No. 2
Mr. David E. Williams	District No. 3
Mr. Robert V. Fleming	District No. 5
Mr. J. T. Brown	District No. 6
Mr. Edward E. Brown	District No. 7
Mr. James H. Penick	District No. 8
Mr. Henry E. Atwood	District No. 9
Mr. James M. Kemper	District No. 10
Mr. Reno Odlin	District No. 12
Mr. Herbert V. Prochnow	Acting Secretary.

Absent:

Mr. John H. McCoy	District No. 4
Mr. Ed H. Winton	District No. 11

On motion, duly made and seconded, the Acting Secretary's notes of the meetings of the Council held on March 9, 10, and 11, 1947; May 18, 19, and 20, 1947, and September 21, 22, and 23, 1947, were approved.

The Council discussed the question of the position it wishes to take now on Bill S. 408.

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

> "The Board is very much concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means."

A comprehensive statement of the viewpoint of the Council on this question may be found in a memorandum presented to the Board of Governors; a copy of this statement is to be found beginning on page 34 of these minutes.

The Council discussed the check collection processes of the Federal Reserve System.

The Council also decided to ask the Board of Governors whether the Board knew of any further developments regarding the bank holding company bill since the last meeting of the Board and the Council.

The meeting adjourned at 5:40 P.M.

HERBERT V. PROCHNOW
Acting Secretary.

November 17, 1947

At 9:45 A.M., the Federal Advisory Council convened in Room 270 of the Mayflower Hotel, Washington, D.C.

Present: Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. W. Randolph Burgess, David E. Williams, John H. McCoy, Robert V. Fleming, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, and Reno Odlin.

Absent: Mr. Ed H. Winton.

The Council prepared and approved the memorandum beginning on page 34 of these minutes to be sent to the Board of Governors relative to the agenda for the joint meeting of the Council and the Board on November 18, 1947. The memorandum was delivered to the Secretary of the Board of Governors at 11:45 A.M. on November 17, 1947. It will be noted that each item of the agenda is listed in the memorandum with the comments of the Council on the item.

The meeting adjourned at 11:25 A.M.

HERBERT V. PROCHNOW
Acting Secretary.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE JOINT MEETING OF NOVEMBER 18, 1947

1. What position does the Council wish to take now on Bill S. 408?

The Council is cognizant of the investigation of the activities and powers of the Reconstruction Finance Corporation now being made by a Congressional Committee. Until Congress has determined whether the Reconstruction Finance Corporation should be continued, and, if continued, what powers to make or guarantee loans should be given it, the Council feels that no action by Congress should be taken on Senate Bill 408. The Council feels that Senate Bill 408 should be considered only as an alternative to legislation continuing the present loan and guarantee powers of the Reconstruction Finance Corporation. If the Congress should decide to continue the Reconstruction Finance Corporation without greatly curtailing its loan and guaranteeing powers, the Council would be opposed to the passage of Senate Bill 408. The majority of the Council would prefer Senate Bill 408 to the continuation of the Reconstruction Finance Corporation powers, but it should also be noted that a minority of the Council is against giving any guarantee or commitment powers to the Federal Reserve Banks under any circumstances, as proposed in Senate Bill 408.

2. The Board is very much concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means.

The Council has reviewed the question of the volume of bank credit both in the aggregate and as shown in the banks with which they are familiar.

We do not know what "serious situation" in bank credit the Board has in mind. For the past year the total volume of bank credit (i.e. the available amount of bank money) as measured by adjusted demand deposits has been practically level. As bank loans have increased, the banks have decreased their investments.

We find nothing in bank loans themselves to suggest that growth of loans has been an active inflationary factor. It rather appears to have been a reflection of the very high level of business activity and high prices.

To a large extent growth of loans is a direct result of government policies. For example, an increase of nearly 4 billion dollars in the real estate loans by insured banks since the end of the war reflects directly the purchase of FHA and GI mortgages in the housing program.

The Reconstruction Finance Corporation is encouraging bank lending by guaranteeing risky loans.

Commercial loans are influenced by high prices and active movement of agricultural and manufactured products for the foreign aid program.

High wages and high costs of materials have meant that business needed more money to take care of its customers.

There is nothing in the figures or our experience to suggest that there exists any substantial lending for speculation or for unnecessary uses. Loans for carrying securities are much reduced.

In this period the government, through the R.F.C., the C.C.C., the P.C.A., and other agencies, has been making loans that the banks refrained from making because of their speculative nature. The Reserve System itself is asking for more power to guarantee loans on the presumption that bank lending is too cautious.

The causes of our present inflation are not in current banking policies but are found in the great war-time expansion of buying power together with unusual events and public policies since that time. Among recent inflationary causes may be listed the following:

The foreign aid program.

A cycle of wage increases in excess of increases in either the cost of living or productivity.

A shorter working week.

A short corn crop.

Veterans bonuses and relief payments.

Agricultural price subsidies.

U. S. Government spending of 36 billion dollars a year.

Housing subsidies.

In the face of these developments a substantial increase in bank loans was inevitable and the banks have shown restraint. The dangers in the present situation are understood by bankers and there is hardly a bank in the country which has not been warning its customers against over-expansion. The loans being made are mostly for direct production.

The first thing to do is to reconsider government policies which are inflationary and especially excessive government spending and subsidies.

We recognize that even though the causes of inflation are largely outside the sphere of monetary policy, the Reserve System has a special responsibility for bank credit and in this situation should take all reasonable care to assure conservative credit policies.

In this special area we suggest that the System and the Treasury already have large powers, without new legislation, to place credit under broad restraints.

One of these powers is the discount rate which is a recognized instrument for serving notice on the public of the need for restraint in the use of credit.

Similarly by open market operations the System can control the reserves of the member banks and limit their lending power.

The Board also still has the power to raise reserve requirements in Central Reserve Cities and so tighten money.

The Treasury by the pricing of new issues and the handling of its balances has great influence on the rate and volume of money.

In the past year the System and the Treasury have used these powers effectively.

The money markets and the policies of business men are today so sensitive to action of these sorts which the Reserve System and the Treasury take that present powers are ample to place all restraints on credit expansion which the System and the Treasury may consider necessary.

The Council wishes it clearly understood that it shares the apprehension of the Board of Governors with respect to inflation dangers. It does, however, most strenuously object to the singling out of the increase in bank loans as a principal contributing factor; and it has attempted to point out above, the vastly more important elements of inflation—of which bank loans are a barometer.

This is not to say that there have not been unwise bank loans in some cases. After all, banking is a form of human endeavor, operated by human beings. It would be amazing if there were not some errors in judgment. But we submit that, on the record, there is no evidence of bank credit expansion beyond that which could be expected under all the circumstances. There is every evidence that loans are today doing a wholesome and constructive work in their intended place in the economy.

The Council has studied the increase in consumer credit in relation to the termination of Regulation W. While consumer credit has increased substantially, much of this reflects the availability of automobiles and household appliances. There is so far too little experience on which to judge the effect of the termination of Regulation W. The American Bankers Association is undertaking with considerable success to ensure maintenance by banks of sound lending standards. This effort towards voluntary cooperation seems to the Council the sensible and the democratic method of dealing with this problem, both with respect to the banks and other lenders. The Council is opposed to legislation giving the Board new regulatory powers in this matter.

3. There is an obligation resting upon the Federal Reserve System constantly to improve and expedite check collection processes for the benefit of industry, agriculture and commerce. A constructive move in this direction is indicated in recent correspondence between the President of the Reserve City Bankers Association and the Chairman of the Board of Governors, copies of which are attached. The Board would appreciate an expression of the views of the Council as to how best to promote and advance the modernization and maximum development of the check collection system.

   The Council appreciates the efficiency of the check collection processes of the Federal Reserve System and the desire of the System constantly to improve and expedite these processes for the benefit of industry, agriculture, and commerce. The Council suggests that when changes in the collection system are being considered by the staffs of the Federal Reserve Banks and the Board of Governors, that the Council be advised regarding the particular operating matters under consideration. The members of the Council are policy-making officials in their respective banks, and they desire an opportunity to refer these questions of bank operation, as they come up, to bank officials handling such problems. The Council, as well as the Board of Governors, may also request the cooperation and advice on these matters of the proper committees of the American Bankers Association and the Reserve City Bankers Association.

No changes in the check collection processes should result in making items available sooner, on the average, than the period required for their collection. For example, for the Federal Reserve Banks to make all items immediately available would be unsound, as it would make funds available when they were not actually collected. It would be the equivalent of granting a loan without interest and of paying a cash subsidy for deposits in the Federal Reserve Banks.

4. The Council would appreciate any information the Board has regarding developments that may have occurred since the last meeting of the Board and the Council in connection with the Bank Holding Company bill.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 17, 1947

At 2:00 P.M., the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D.C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. W. Randolph Burgess, David E. Williams, John H. McCoy, Robert V. Fleming, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, Reno Odlin, and Herbert V. Prochnow, Acting Secretary.

Absent: Mr. Ed H. Winton.

Mr. J. Burke Knapp, Assistant Director of Research and Statistics of the Federal Reserve System, discussed "Certain Aspects of the European Recovery Program."

The meeting adjourned at 5:00 P.M.

HERBERT V. PROCHNOW
Acting Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 18, 1947

At 9:30 A.M. the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D.C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. W. Randolph Burgess, David E. Williams, John H. McCoy, Robert V. Fleming, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, Reno Odlin, and Herbert V. Prochnow, Acting Secretary.

Absent: Mr. Ed H. Winton.

The Council prepared and approved the statement below to be presented to the Board of Governors at the joint meeting with the Board of Governors at 10:30 A.M., November 18, 1947. The statement is to be given to the Board in connection with and in addition to the Council's statement on point two of the agenda, as given in these printed minutes on pages 34, 35 and 36.

* * * *

Suggestions in the President's message to Congress with respect to credit control indicate the possibility that the Federal Reserve Board may present to Congress the proposal in its 1945 Annual Report for a required bank reserve of short term government securities. The Council therefore wishes to state its views on this proposal.

The proposal as we understand it is that banks should be required by law to maintain, in addition to cash reserves, reserves of short term government securities in a percentage relationship to deposits, to be fixed from time to time by the Federal Reserve Board.

The Council is unanimously opposed to this scheme for the following reasons:

(1) It is impractical. The operations of banks are so different, reflecting as they do adaptation to the varying needs of their communities and customers, that no percentage of short term government security holdings can be applied fairly or practically to all banks. Any percentage high enough to offer any measure of restraint on a substantial number of banks will have disastrous effects on many other banks, compelling them to liquidate sound and necessary loans and thus actually check production. The very banks which have served the business in their communities most aggressively and helpfully would be hardest hit.

(2) Such a plan would substitute the edicts of a board in Washington for the judgments of the boards of directors of 15,000 banks throughout the country as to the employment of a substantial part of the funds of their banks. This is a step towards socialization of banking.

(3) As indicated earlier, the Federal Reserve System and the Treasury already possess large powers of credit control not now being fully used. Such new powers as those proposed are not necessary.

The meeting adjourned at 10:20 A.M.

HERBERT V. PROCHNOW
Acting Secretary.

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

November 18, 1947

At 10:40 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 M. S. Szymczak, Ernest G. Draper, R. M. Evans, James K. Vardaman, Jr., and Lawrence Clayton; also S. R. Carpenter, Secretary of the Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Charles E. Spencer, Jr., Vice President; Messrs. W. Randolph Burgess, David E. Williams, John H. McCoy, Robert V. Fleming, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, Reno Odlin, and Herbert V. Prochnow, Acting Secretary.

Absent: Mr. Ed H. Winton.

The President of the Council stated the position of the Council on Bill S. 408 as expressed in the Council's statement in these minutes on page 34.

Chairman Eccles said that the Council's viewpoint is agreeable to the Board, especially since it indicates a preference for Senate Bill 408, compared to the continuation of the powers of the Reconstruction Finance Corporation.

In connection with item two of the agenda, the President of the Council read the statement which the Council had prepared on this item, as given in these minutes beginning on page 34 in the confidential memorandum which the Council sent the Board.

The President of the Council also read the additional statement which the Council prepared at its meeting earlier on November 18, 1947, a copy of which is included in these minutes on page 39.

President Brown then stated that the Council would like these statements which he had read and which represent the Council's viewpoint on point two of the agenda submitted by the Chairman of the Board of Governors to the proper committees of Congress when the Chairman testifies before these committees on these matters.

Chairman Eccles replied that he would be glad to present these statements of the Council to the proper Congressional committees.

There was a lengthy discussion regarding the question of the expansion of bank credit, during which Chairman Eccles outlined the proposal the Board intends to make to Congress for legislation requiring banks to set up special reserves.

Chairman Eccles stated that the Board is not critical of any bank or the banking system in its operations in connection with the problem of inflation. He stated that no individual bank can be criticised for taking care of its customers on sound loans.

The President of the Council stated that the Council appreciates the efficiency of the check collection processes of the Federal Reserve System and the desire of the System constantly to improve and expedite these processes for the benefit of industry, agriculture, and commerce. He said that the Council suggests that when changes in the collection system are being considered by the staffs of the Federal Reserve Banks and the Board of Governors, that the Council be advised regarding the particular operating matters under consideration. The members of the Council are policy-making officials in their respective banks, and they desire an opportunity to refer these questions of bank operation, as they come up, to bank officials handling such problems. The Council, as well as the Board of Governors, may also request the cooperation and advice on these matters of the proper committees of the American Bankers Association and the Reserve City Bankers Association.

President Brown also stated that no changes in the check collection processes should result in making items available sooner, on the average, than the period required for their collection. For example, for the Federal Reserve banks to make all items immediately available would be unsound, as it would make funds available when they were not actually collected. It would be the equivalent of granting a loan without interest and of paying a cash subsidy for deposits in the Federal Reserve banks.

Chairman Eccles reported that the Board believes it should deal with the Council and not with bankers associations on these matters as the Council is the statutory body representing all bankers. Chairman Eccles also stated that the Board of Governors does not agree that giving immediate availability is unsound. The Board believes that giving immediate availability to items would eliminate much analyzing of accounts and would be beneficial to banks, businesses, and industry.

Chairman Eccles said that there is nothing new regarding the bank holding company bill except that the western group of Independent Bankers and the State Banking Commissioners in recent conventions have both passed resolutions favoring the bill.

The Chairman of the Board adds that there may be one or two additional amendments to the bill.

Chairman Eccles reported that the banks are losing their consumer credit loans, as merchants can extend consumer credit without any down payments because their profits enable them to take losses which the banks are not in a position to incur.

The meeting adjourned at 3:12 P.M.

HERBERT V. PROCHNOW
Acting Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 18, 1947

At 3:15 P.M., the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D.C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. W. Randolph Burgess, David E. Williams, John H. McCoy, Robert V. Fleming, J. T. Brown, James H. Penick, Henry E. Atwood, James M. Kemper, Reno Odlin and Herbert V. Prochnow, Acting Secretary.

Absent: Ed H. Winton.

President Brown asked whether the Council wishes to change its statement on point two of the agenda, point two reading as follows:

> The Board is very much concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means.

After discussing the matter, the Council approved the statement which follows on pages 43, 44 and 45 of these minutes and requested that the statement be presented to the Chairman of the Board of Governors who was to be asked to submit the statement to the proper committees of Congress at the time the Chairman of the Board of Governors testifies before these committees on these matters.

The meeting adjourned at 4:00 P.M.

HERBERT V. PROCHNOW
Acting Secretary.

The Board of Governors of the Federal Reserve System submitted the following question to the Federal Advisory Council:

"The Board is very concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means."

The Federal Advisory Council gave the Board of Governors the following statement in answer to the foregoing question:

The Council has reviewed the question of the volume of bank credit both in the aggregate and as shown in the banks with which they are familiar.

We do not know what "serious situation" in bank credit the Board has in mind. For the past year the total volume of bank credit (i.e. the available amount of bank money) as measured by adjusted demand deposits has shown only a moderate increase. As bank loans have increased, the banks have decreased their investments.

We find nothing in bank loans themselves to suggest that growth of loans has been an active inflationary factor. It rather appears to have been a reflection of the very high level of business activity and high prices.

To a large extent growth of loans is a direct result of government policies. For example, an increase of nearly 4 billion dollars in the real estate loans by insured banks since the end of the war reflects directly the purchase of FHA and GI mortgages in the housing program.

The Reconstruction Finance Corporation is encouraging bank lending by guaranteeing risky loans.

Commercial loans are influenced by high prices and active movement of agricultural and manufactured products for the foreign aid program.

High wages and high costs of materials have meant that business needed more money to take care of its customers.

There is nothing in the figures or our experience to suggest that there exists any substantial lending for speculation or for unnecessary uses. Loans for carrying securities are much reduced.

In this period the government, through various agencies, has been making loans that the banks refrained from making because of their speculative nature. The Reserve System itself is asking for more power to guarantee loans on the presumption that bank lending is too cautious.

The causes of our present inflation are not in current banking policies but are found in the great war-time expansion of buying power together with unusual events and public policies since that time. Among recent inflationary causes may be listed the following:

The foreign aid program.

A cycle of wage increases in excess of increases in either the cost of living or productivity.

A shorter working week.

A short corn crop.

Veterans bonuses and relief payments.

Agricultural price subsidies.

U. S. Government spending of 36 billion dollars a year.

Housing subsidies.

In the face of these developments a substantial increase in bank loans was inevitable and the banks have shown restraint. The dangers in the present situation are understood by bankers and there is hardly a bank in the country which has not been warning its customers against overexpansion. The loans being made are mostly for direct production.

The first thing to do is to reconsider government policies which are inflationary and especially excessive government spending and subsidies.

We recognize that even though the causes of inflation are largely outside the sphere of monetary policy, the Reserve System has a special responsibility for bank credit and in this situation should take all reasonable care to assure conservative credit policies.

In this special area we suggest that the System and the Treasury already have large powers, without new legislation, to place credit under broad restraints.

One of these powers is the discount rate which is a recognized instrument for serving notice on the public of the need for restraint in the use of credit.

Similarly by open market operations the System can control the reserves of the member banks and limit their lending power.

The Board also still has the power to raise reserve requirements in Central Reserve Cities and so tighten money.

The Treasury by the pricing of new issues and the handling of its balances has great influence on the rate and volume of money.

In the past year the System and the Treasury have used these powers effectively.

The money markets and the policies of business men are today so sensitive to action of these sorts which the Reserve System and the Treasury take that present powers are ample to place all restraints on credit expansion which the System and the Treasury may consider necessary.

The Council wishes it clearly understood that it shares the apprehension of the Board of Governors with respect to inflation dangers. It does, however, most strenuously object to the singling out of the increase in bank loans as a principal contributing factor; and it has attempted to point out above, the vastly more important elements of inflation—of which bank loans are a barometer.

This is not to say that there have not been unwise bank loans in some cases. After all, banking is a form of human endeavor, operated by human beings. It would be amazing if there were not some errors in judgment. But we submit that, on the record, there is no evidence of bank credit expansion beyond that which could be expected under all the circumstances. There is every evidence that loans are today doing a wholesome and constructive work in their intended place in the economy.

The Council has studied the increase in consumer credit in relation to the termination of Regulation W. While consumer credit has increased substantially, much of this reflects the availability of automobiles and household appliances. There is so far too little experience on which to judge the effect of the termination of Regulation W. The American Bankers Association is undertaking with considerable success to ensure maintenance by banks of sound lending standards. This effort towards voluntary cooperation seems to the Council the sensible and the democratic method of dealing with this problem, both with respect to the banks and other lenders. The Council is opposed to legislation giving the Board new regulatory powers in this matter.

Suggestions in the President's message to Congress with respect to credit control indicate the possibility that the Federal Reserve Board may present to Congress the proposal in its 1945 Annual Report for a required bank reserve of short term government securities. The Council therefore wishes to state its views on this proposal.

The proposal as we understand it is that banks should be required by law to maintain, in addition to cash reserves, reserves of short term government securities in a percentage relationship to deposits, to be fixed from time to time by the Federal Reserve Board.

The Council is unanimously opposed to this scheme for the following reasons:

(1) It is impractical. The operations of banks are so different, reflecting as they do adaptation to the varying needs of their communities and customers, that no percentage of short term government security holdings can be applied fairly or practically to all banks. Any percentage high enough to offer any measure of restraint on a substantial number of banks will have disastrous effects on many other banks, compelling them to liquidate sound and necessary loans and thus actually check production. The very banks which have served the business in their communities most aggressively and helpfully would be hardest hit.

(2) Such a plan would substitute the edicts of a board in Washington for the judgments of the boards of directors of 15,000 banks throughout the country as to the employment of a substantial part of the funds of their banks. This is a step towards socialization of banking.

(3) As indicated earlier, the Federal Reserve System and the Treasury already possess large powers of credit control not now being fully used. Such new powers as those proposed are not necessary.

* * * * *

Mr. Spencer, Vice President and Mr. Prochnow, Acting Secretary of the Council, submitted copies of the above statement immediately following the meeting of the Council to Chairman Eccles and Mr. Carpenter, Secretary of the Board, with the request that the statement be submitted to the proper committees of Congress when Chairman Eccles testifies before these committees.

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

H.V.P.

The Acting Secretary's notes on the meeting of the Federal Advisory Council on November 16, 1947, at 2:00 P.M., in Room 270 of the Mayflower Hotel, Washington, D.C.

All members of the Federal Advisory Council were present, except Mr. John H. McCoy (who was ill) and Mr. Ed H. Winton.

The Acting Secretary's notes of the meetings of the Council on March 9, 10, and 11, 1947, May 18, 19, and 20, 1947, and September 21, 22 and 23, 1947, copies of which had been sent previously to the members, were approved.

WHAT POSITION DOES THE COUNCIL WISH TO TAKE NOW ON BILL S. 408?

E. E. Brown states that at the last joint meeting of the Council and the Board, the Board asked the Council to defer an expression of its opinion regarding Bill S. 408 until the next joint meeting of the Board and the Council on November 18. Brown asks members of the Council for their viewpoints on the bill.

Burgess. Is there anything new on the bill?

Kemper. Has the Association of Reserve City Bankers done anything to reverse its position on Bill S. 408?

Fleming does not believe the Association of Reserve City Bankers has reversed its position.

Spencer asks the Acting Secretary to read the section of the minutes of the Association of Reserve City Bankers which states the Association's present position. The Acting Secretary then reads the following excerpt from the minutes of the meeting of the Committee on Federal Relationships of the Association of Reserve City Bankers held September 28, 1947, at the Traymore Hotel, Atlantic City, New Jersey.

Proposed amendment to Section 13(b) of the Federal Reserve Act -

Senate Bill 408. "It was reported that the powers of the Reconstruction Finance Corporation, in respect of the guarantee of bank loans, which were to expire by limitation on June 30, 1947, had been extended by Act of Congress subsequent to the Swampscott meeting of the Association. The Association policy as established at the Swampscott meeting, through the adoption of the Report of the Committee on Federal Relationships, is that, so long as such guarantee powers are continued in the Reconstruction

Finance Corporation such powers should not be granted to the Federal Reserve Banks. In view of the rather closely divided vote by which this Committee, as then constituted, reached its decision last May, plus some apparent shifting of thinking on the part of some carry-over members of the Committee, the question was raised whether the Committee should rest on the Swampscott resolution or at this time move into new ground. Opinions seemed to range from resting on the Swampscott resolution all the way to an outright opposition to any such lending or guarantee powers in the Federal Reserve Banks. A very full discussion, accompanied by a variety of rather defined opinions, resulted in the unanimous adoption of a resolution, reading as follows:

"So long as direct loaning and guarantee of bank loan powers (not limited to emergency or disaster loans or loans vital to the national security and economy) are continued in the Reconstruction Finance Corporation, we are opposed to Senate Bill 408 and feel that the Federal Reserve System should desist from further direct loans under existing Section 13(b) of the Federal Reserve Act.

"The Chairman was requested to submit this resolution to the Board of Directors and ask that it be adopted as Association policy pending further action by the membership at the next annual meeting.

"Note: The Board of Directors, at its meeting in Atlantic City on September 29, 1947, approved the above resolution as expressing Association policy, pending further action of the membership."

J. T. Brown states that the Federal Reserve bank in his district is making direct loans to agriculture.

Fleming believes the RFC is a dangerous agency and thinks its powers should be curtailed.

Atwood asks Fleming if he believes the powers of the RFC should be eliminated before passing Bill S. 408.

Fleming. Yes.

Atwood says his associates have criticised him for voting for Bill S. 408 and he wishes to change his vote to be against it.

Kemper. Bill S. 408 is just another step in the nationalization of banks.

E. E. Brown thinks the RFC powers should be restricted largely to loans which affect the national welfare, such as disaster and drought loans. The RFC should have no power to make loans to small businesses.

Williams thinks there is much in Kemper's viewpoint. He believes the Council should change its vote now that the life of the RFC has been continued. The Council should now oppose Bill S. 408.

Fleming reports the life of the RFC was extended until June 30, 1948, only because there was not sufficient time for Congress to investigate the whole matter.

Penick states he voted for Bill S. 408 because he believes it would be better for this power to be lodged in the Federal Reserve banks rather than in the RFC. He thinks the Federal Reserve banks make better loans than the RFC.

Burgess agrees with Penick. He states that as a matter of fact, in the present inflationary situation, the country does not need these powers in either agency. He thinks the Council might state that until the RFC situation is clarified, there is no reason for passing Bill S. 408. As between the two agencies, the Council may state it would prefer to see the power in the Federal Reserve banks.

J. T. Brown believes the power should be in the Federal Reserve banks if it is anywhere. He prefers the Federal Reserve banks to the RFC. However, he believes approval should be based on the elimination of the RFC powers.

Odlin agrees with Burgess. He thinks the Council can reassert the position it took previously.

Spencer believes Bill S. 408 would be satisfactory with the restrictions the Council has expressed.

E. E. Brown. The views of the Council seem to fall into three groups: (1) the largest group of members feels that until Congress has passed on the extension of the RFC and its powers, Bill S. 408 should not be passed; (2) a minority feels that under no circumstances should the powers of Bill S. 408 be granted; and, (3) another minority group feels that even if the RFC is extended, Bill S. 408 should be passed. He asks whether the Council would wish to state that until the powers of the RFC are determined, any action of the Council would be premature. The members of the Council indicate approval of this idea.

Fleming states that perhaps the Council could say it is cognizant of the investigation of the activities and powers of the RFC now being made by a Congressional committee. Until Congress has determined whether the RFC should be continued, and, if continued, what powers to make or guarantee loans should be given it, the Council feels that no action by Congress should be taken on Bill S. 408.

Kemper thinks that if the Council temporizes on the matter, it will weaken its position.

E. E. Brown adds that the Council's statement on the matter may also include a statement that a minority of the Council is against giving any guarantee or commitment powers to the Federal Reserve banks under any circumstances, as proposed in Bill S. 408.

THE BOARD IS VERY MUCH CONCERNED ABOUT THE RAPID EXPANSION OF BANK CREDIT. THE BOARD, THEREFORE, DESIRES TO HAVE THE VIEWS OF THE COUNCIL AS TO THE FURTHER STEPS THAT MIGHT BE TAKEN TO CORRECT THIS SERIOUS SITUATION THROUGH MONETARY OR FISCAL MEANS.

E. E. Brown thinks Eccles may be trying by one means or another to require banks to maintain reserves in the form of short term governments. He believes Eccles may also ask for the reinstatement of Regulation W controls.

Fleming. This agenda item which the Board has proposed is undoubtedly a forerunner to proposals to be made by Eccles. If the Council makes no suggestions regarding this agenda item, Eccles will present his proposals for controlling credit and will say that the Council has made no suggestions. Fleming calls attention to one or two Republican Congressmen who have come out for the reinstatement of Regulation W.

E. E. Brown states that he regrets to see Senator Taft has come out for the reinstatement of Regulation W controls, but Brown thinks Regulation W is a relatively minor matter in relation to the whole question, particularly the granting of powers to the Board which would enable the Board to indicate how much of the deposits of banks should be kept in short term government securities.

Burgess reports that the ABA has been making a survey in over fifty cities and has found that most banks in those cities are observing Regulation W terms. Consequently, the bankers can say that they are generally following Regulation W terms. If Congress gives the Board powers permanently to reinstate Regulation W. it will be bad. If Regulation W is reinstated under the present emergency powers, these will eventually end and the controls will be washed out. It is possible to have Regulation W by (1) voluntary means; (2) Presidential order under emergency powers; and (3) by Congress giving the Board the power. Burgess thinks the Council should state it is in favor of the voluntary method; in time of peace voluntary methods should be used.

Spencer does not wish the regulation reinstated.

Fleming. If you get away from consumer credit and consider the larger volume of loans, the increase is due to a considerable extent to higher prices.

E. E. Brown does not believe the Board should be given consumer credit control as a permanent part of the economy.

Burgess. Since the regulation is ended, the banks are doing a satisfactory job by voluntary methods. Some groups, like the department stores, are breaking down the terms, but voluntary cooperation should be attempted.

Odlin states that Regulation W cannot be policed, and did not work satisfactorily. He says that the present inflation is based on something more than bank loans.

J. T. Brown is opposed to having Congress reimpose Regulation W controls.

Burgess asks whether the larger mail order companies would not come into line voluntarily, if they were requested by the Administration.

E. E. Brown doubts it. Brown has had a feeling in the last thirty days that there is some lull in the demand for loans.

Spencer asks whether it is a lull or the end of the season for certain loans.

E. E. Brown. Some loans are seasonal, like the grain loans and the loans for Christmas inventory, which should shortly be liquidated. However, Brown thinks some firms are less desirous now of borrowing to expand and build because costs are too high.

Burgess states that the security markets have not been good for expansion. It takes a great deal of money also to handle grain, for example, at these prices. Title VI, agricultural subsidies, wage policies, and other government activities have been responsible for the present situation.

Odlin thinks attention should be called to those factors that have really caused the present inflation.

E. E. Brown believes three things might be done by the Board: (1) raise the reserve requirements in New York City and Chicago to 26 per cent; (2) increase the Federal Reserve discount rate, perhaps to 1¼ or 1½ per cent; and (3) perhaps not help to keep up government bond prices by open market operations. However, the Board may feel it cannot permit eligible issues to fall below par. Brown is inclined to favor increasing the reserves to 26 per cent in the central reserve cities.

Burgess believes that increasing reserves to 26 per cent in the central reserve cities would only result in the banks selling their bonds to the Federal Reserve System.

E. E. Brown. If the rates should be raised to 26 per cent, it would permit the Board greater latitude in reducing reserves in case of depression. It would also tend to make the banks more cautious. Brown favors raising the discount rate of the Federal Reserve banks to 1¼ or 1½ per cent, and he believes this would have a greater effect than a raise to 6 per cent would have had a number of years ago.

Burgess states that anything which is done will affect the bond market. The Board has all the power it needs. The situation is similar to that existing in 1929 when the Board was looking for someone else to pull the string.

E. E. Brown. Eccles may argue that no steps may be taken which would force any government bonds below par.

Kemper. With an election year coming on, Kemper does not believe traditional remedies will be tried, but the Council should probably go on record. He doubts whether it is desirable to say that the banks have no part in causing the inflationary spiral.

Spencer believes anything that is done will bring pressure on government bonds. The powers the Board has are (1) the 6 per cent increase in the reserves of central reserve cities; (2) open market operations; and (3) raising the discount rate of Federal Reserve banks.

Burgess asks whether the Council should not point out that the main source of the inflation is not monetary, but is due to such factors as agricultural subsidies, minimum wage and hour policies, Title VI and subsidized housing.

Atwood likes Odlin's suggestion.

Odlin does not believe there is any real expansion in commercial bank credit.

Burgess thinks the Council should point out the factors other than bank loans that have really caused the inflation. He states there is no substantial volume of loans for carrying securities.

E. E. Brown replies that the Board would answer by saying that the 75 per cent margin requirement has held down the volume of security loans.

Williams believes the Council may combine the viewpoints of Odlin and Burgess, pointing out that the Council disagrees with Eccles' statement on the great increase in bank loans, calling attention to the major factors that have made the inflation and stating the powers which the Board has, but has not used.

Burgess states the Board has three important powers left: (1) the open market powers; (2) the power to raise the discount rate of the Federal Reserve banks; and (3) the power to raise the reserves in central reserve cities to 26 per cent.

E. E. Brown has heard that many country banks have gone into real estate loans and long term governments.

Kemper questions the statement of Mr. French of the American Bankers Association that banks are holding to Regulation W terms and are not liberalizing their consumer credit terms. Kemper thinks they are liberalizing their terms or are on the verge of it.

Fleming. The ABA recommendations are more liberal than Regulation W.

Kemper. The banks are making loans to finance companies who are liberalizing the terms.

Fleming. Most country banks in Maryland and Virginia hold many real estate loans.

Spencer. If you raise the reserve requirements of the country banks, they will sell government bonds.

Kemper is inclined to believe there may be some sense in the viewpoint of Eccles that bank loans are going up too rapidly.

E. E. Brown. The individual bank is more or less helpless. If a good customer with excellent credit standing, possibly with more cash in the bank than the amount of the loan he requests, wishes to borrow, no bank will hesitate to grant the credit. However, the loan may be used for purchases which will add to the inflationary spiral. A raise in the Federal Reserve bank discount rate may make a borrower of that kind more cautious. Brown thinks the Council cannot go to the Board with a purely negative program. He thinks the Council should suggest an increase in the reserves in the Central reserve cities to 26 per cent, an increase of 1/4 or 1/2 per cent in the discount rate of the Federal Reserve banks, and a tightening of the exceedingly liberal terms on which real estate loans are being granted. Raising the reserves to 26 per cent should have a good psychological effect, and when the inflation breaks it would give the Board more latitude in lowering reserves. One argument against raising the reserves in New York City and Chicago to 26 per cent is that it penalizes these two cities as compared with the reserve cities.

Fleming. Are not all members of the Council opposed to the certificate plan?

E. E. Brown believes it would be better, if legislation should come, to increase the reserves, for example, to 30 per cent in the central reserve cities, 25 per cent in the reserve cities and 20 per cent in country banks, rather than to have the certificate plan. Brown is not certain that there should be differences in the reserve requirements between classes of cities.

Burgess. The Federal Reserve banks are filled with governments, and they could take up any excess reserves by selling government securities. This would affect the government bond market, but so does raising the reserves which leads banks to sell bonds. Legislation to raise reserve requirements now does not make sense.

Atwood. It takes only a little change in psychology to bring on a decline.

E. E. Brown. Should we suggest definite action, or call attention to the three powers the Board might use, which would have a powerfully deterrent effect on credit, without the Board asking for new powers. Brown thinks the war loan deposit accounts should also be reduced further. This is a fourth power available, and it has a cumulative effect.

Fleming. Should the war loan deposit accounts be remitted every thirty days?

E. E. Brown. They are reducing them now. When $2,000,000 goes out of our war loan account, it means that in two or three days our correspondent bank balances may decline $6,000,000. For the first time in a long period there is a tight money situation in New York City and Chicago.

Fleming suggests a drafting committee on this point.

E. E. Brown. A rediscount rate of $1\frac{1}{2}$ per cent might raise the $1\frac{1}{2}$ per cent rate on loans. Brown understands the Council's viewpoint might be summarized as follows: (1) the expansion of bank credit is a symptom of high prices and an effect more than a contributing cause; (2) the Board has these powerful weapons - open market operations-raising the discount rate of the Federal Reserve banks - and raising the reserve rate in the central reserve cities to 26 per cent; (3) and the reduction of war loan deposits would have a cumulative effect. Fiscal policies which contribute to the inflation are the liberal terms under which real estate loans are made to veterans and others, agricultural subsidies, limitation on the hours of labor, housing subsidies, wage increases and other factors. The psychological effect of raising the rediscount rate would be helpful; it may affect the government bond market, but any plan to restrict credit will affect the government bond market.

THERE IS AN OBLIGATION RESTING UPON THE FEDERAL RESERVE SYSTEM CONSTANTLY TO IMPROVE AND EXPEDITE CHECK COLLECTION PROCESSES FOR THE BENEFIT OF INDUSTRY, AGRICULTURE AND COMMERCE. A CONSTRUCTIVE MOVE IN THIS DIRECTION IS INDICATED IN RECENT CORRESPONDENCE BETWEEN THE PRESIDENT OF THE RESERVE CITY BANKERS ASSOCIATION AND THE CHAIRMAN OF THE BOARD OF GOVERNORS, COPIES OF WHICH ARE ATTACHED. THE BOARD WOULD APPRECIATE AN EXPRESSION OF THE VIEWS OF THE COUNCIL AS TO HOW BEST TO PROMOTE AND ADVANCE THE MODERNIZATION AND MAXIMUM DEVELOPMENT OF THE CHECK COLLECTION SYSTEM.

E. E. Brown says he understands a study has been made contemplating the absorption of all float by the Federal Reserve banks. This would make the float available at once and so would be inflationary. Some of the Federal Reserve banks absorb part of the float now. The Federal Reserve bank of Chicago gives credit on Saturday for New York City items which ordinarily, with the New York City banks closed on Saturday, would not be available until Monday. Brown believes the Board should work with the proper committees of the American Bankers Association and the Association of Reserve City Bankers on operating matters of this kind. The Federal Advisory Council cannot adequately deal with all the detailed mechanical operations of the banking system.

Fleming. This is an operating problem and should be threshed out with the proper committees of the American Bankers Association and the Association of Reserve City Bankers.

Williams says that the president of the Federal Reserve bank of Philadelphia believes that items should be made available immediately.

E. E. Brown. If immediate availability is granted, it will reduce correspondent bank relationships. It will also tend to force banks which are not now members into the Federal Reserve System.

Burgess thinks immediate availability is unsound as it makes money available before it is actually collected. It is a loan without interest. The Council may state that it appreciates the efficiency of the check collection processes of the Federal Reserve System, but that immediate availability is unsound. Moreover, it tends to destroy the established correspondent bank relationships.

E. E. Brown. Any system for the collection of checks ought not to make items available sooner than the period required, on the average, for their collection.

J. T. Brown thinks this matter should be referred to a committee of the American Bankers Association for consideration. He believes that the interest which the members of the Association of Reserve City Bankers have in maintaining correspondent bank relationships might be considered to prejudice their viewpoint on this subject.

Fleming says that the Council may request a report from an ABA committee and an Association of Reserve City Bankers committee to give to the Board.

E. E. Brown states that perhaps the Council can say it is asking the ABA to set up a committee to give the matter consideration.

Penick. If we tell Eccles to take it up with another committee, he may work with that committee and ignore the Council.

Fleming agrees.

Odlin agrees.

E. E. Brown. No change in the check collection system should result in making available items sooner, on the average, than the period required for their actual collection. When changes in the collection system are being considered by the staffs of the Federal Reserve banks and the Board of Governors, it is suggested that the Council be informed regarding the particular operating matters under consideration.

Fleming. The members of the Council are policy-making officials and they desire to refer these matters, as they come up, to bank officials handling such problems for their advice.

E. E. Brown. Immediate availability is equivalent to making a loan without interest, and it makes funds available when they are not actually collected. It places correspondent bank relationships at a disadvantage.

Fleming reads a confidential memorandum regarding a national bank examiner who urged a bank to reduce its correspondent bank balances. Fleming has taken up the matter with the Comptroller's office.

Penick thinks the presidents of the Federal Reserve banks may be promoters of those ideas which advance the Federal Reserve System at the expense of correspondent bank relationships.

Odlin states that on the Pacific coast the relationship of the banks with the Federal Reserve bank has been good.

BANK HOLDING COMPANY BILL

E. E. Brown asks whether the Council wishes to inquire from the Board whether the Board has any information regarding the developments that may have occurred since the last meeting of the Board and the Council in connection with the bank holding company bill. Brown noted that the members of the Council approve asking the Board for this information.

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In the course of the discussion during the afternoon there were comments from several members about a new ruling which limits expenditures of various Federal Reserve officials to $8 per day while traveling. There were also comments regarding the advisability of taking up with the Board again the question particularly of pensions for Federal Reserve employees. It was decided that these matters might be deferred until the next meeting of the Council.

The meeting adjourned at 5:40 P.M.

The Council convened at 9:45 A.M. on November 17, 1947, in Room 270 of the Mayflower Hotel, Washington, D.C.

All members of the Council were present except Mr. Ed H. Winton.

The Council prepared and approved the attached memorandum to be sent to the Board of Governors relative to the agenda for the joint meeting of the Council and the Board on November 18, 1947. The memorandum was delivered to the Secretary of the Board of Governors at 11:45 A.M. on November 17, 1947. It will be noted that each item of the agenda is listed with the comments of the Council on the item.

The meeting adjourned at 11:25 A.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON NOVEMBER 18, 1947

1. What position does the Council wish to take now on Bill S. 408?

The Council is cognizant of the investigation of the activities and powers of the Reconstruction Finance Corporation now being made by a Congressional Committee. Until Congress has determined whether the Reconstruction Finance Corporation should be continued, and, if continued, what powers to make or guarantee loans should be given it, the Council feels that no action by Congress should be taken on Senate Bill 408. The Council feels that Senate Bill 408 should be considered only as an alternative to legislation continuing the present loan and guarantee powers of the Reconstruction Finance Corporation. If the Congress should decide to continue the Reconstruction Finance Corporation without greatly curtailing its loan and guaranteeing powers, the Council would be opposed to the passage of Senate Bill 408. The majority of the Council would prefer Senate Bill 408 to the continuation of the Reconstruction Finance Corporation powers, but it should also be noted that a minority of the Council is against giving any guarantee or commitment powers to the Federal Reserve Banks under any circumstances, as proposed in Senate Bill 408.

2. The Board is very much concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means.

The Council has reviewed the question of the volume of bank credit both in the aggregate and as shown in the banks with which they are familiar.

We do not know what "serious situation" in bank credit the Board has in mind. For the past year the total volume of bank credit (i.e. the available amount of bank money) as measured by adjusted demand deposits has been practically level. As bank loans have increased, the banks have decreased their investments.

We find nothing in bank loans themselves to suggest that growth of loans has been an active inflationary factor. It rather appears to have been a reflection of the very high level of business activity and high prices.

To a large extent growth of loans is a direct result of government policies. For example, an increase of nearly 4 billion dollars in the real estate loans by insured banks since the end of the war reflects directly the purchase of FHA and GI mortgages in the housing program.

The Reconstruction Finance Corporation is encouraging bank lending by guaranteeing risky loans.

Commercial loans are influenced by high prices and active movement of agricultural and manufactured products for the foreign aid program.

High Wages and high costs of materials have meant that business needed more money to take care of its customers.

There is nothing in the figures or our experience to suggest that there exists any substantial lending for speculation or for unnecessary uses. Loans for carrying securities are much reduced.

In this period the government, through the R.F.C., the C.C.C., the P.C.A., and other agencies, has been making loans that the banks refrained from making because of their speculative nature. The Reserve System itself is asking for more power to guarantee loans on the presumption that bank lending is too cautious.

The causes of our present inflation are not in current banking policies but are found in the great war-time expansion of buying power together with unusual events and public policies since that time. Among recent inflationary causes may be listed the following:

The foreign aid program

A cycle of wage increases in excess of increases in either the cost of living or productivity

A shorter working week

A short corn crop

Veterans bonuses and relief payments

Agricultural price subsidies

U. S. Government spending of 36 billion dollars a year

Housing subsidies

In the face of these developments a substantial increase in bank loans was inevitable and the banks have shown restraint. The dangers in the present situation are understood by bankers and there is hardly a bank in the country which has not been warning its customers against over-expansion. The loans being made are mostly for direct production.

The first thing to do is to reconsider government policies which are inflationary and especially excessive government spending and subsidies.

We recognize that even though the causes of inflation are largely outside the sphere of monetary policy, the Reserve System has a special responsibility for bank credit and in this situation should take all reasonable care to assure conservative credit policies.

In this special area we suggest that the System and the Treasury already have large powers, without new legislation, to place credit under broad restraints.

One of these powere is the discount rate which is a recognized instrument for serving notice on the public of the need for restraint in the usc of credit.

Similarly by open market operations the System can control the reserves of the member banks and limit their lending power.

The Board also still has the power to raise reserve requirements in Central Reserve Cities and so tighten money.

The Treasury by the pricing of new issues and the handling of its balances has great influence on the rate and volume of money.

In the past year the System and the Treasury have used these powers effectively.

The money markets and the policies of business men are today so sensitive to action of these sorts which the Reserve System and the Treasury take that present powers are ample to place all restraints on credit expansion which the System and the Treasury may consider necessary.

The Council wishes it clearly understood that it shares the apprehension of the Board of Governors with respect to inflation dangers. It does, however, most strenuously object to the singling out of the increase in bank loans as a principal contributing factor; and it has attempted to point out above, the vastly more important elements of inflation - of which bank loans are a barometer.

This is not to say that there have not been unwise bank loans in some cases. After all, banking is a form of human endeavor, operated by human beings. It would be amazing if there were not some errors in judgment. But we submit that, on the record, there is no evidence of bank credit expansion beyond that which could be expected under all the circumstances. There is every evidence that loans are today doing a wholesome and constructive work in their intended place in the economy.

The Council has studied the increase in consumer credit in relation to the termination of Regulation W. While consumer credit has increased substantially, much of this reflects the availability of automobiles and household appliances. There is so far too little experience on which to judge the effect of the termination of Regulation W. The American Bankers Association is undertaking with considerable success to ensure maintenance by banks of sound lending standards. This effort toward voluntary cooperation seems to the Council the sensible and the democratic method of dealing with this problem, both with respect to the banks and other lenders. The Council is opposed to legislation giving the Board new regulatory powers in this matter.

3. There is an obligation resting upon the Federal Reserve System constantly to improve and expedite check collection processes for the benefit of industry, agriculture and commerce. A constructive move in this direction is indicated in recent correspondence between the President of the Reserve City Bankers Association and the Chairman of the Board of Governors, copies of which are attached. The Board would appreciate an expression of the views of the Council as to how best to promote and advance the modernization and maximum development of the check collection system.

The Council appreciates the efficiency of the check collection processes of the Federal Reserve System and the desire of the System constantly to improve and expedite these processes for the benefit of industry, agriculture, and commerce. The Council suggests that when changes in the collection system are being considered by the staffs of the Federal Reserve Banks and the Board of Governors, that the Council be advised regarding the particular operating matters under consideration. The members of the Council are policy-making officials in their respective banks, and they desire an opportunity to refer these questions of bank operation, as they come up, to bank officials handling such problems. The Council, as well as the Board of Governors, may also request the cooperation and advice on these matters of the proper committees of the American Bankers Association and the Reserve City Bankers Association.

No changes in the check collection processes should result in making items available sooner, on the average, than the period required for their collection. For example, for the Federal Reserve Banks to make all items immediately available would be unsound, as it would make funds available when they were not actually collected. It would be the equivalent of granting a loan without interest and of paying a cash subsidy for deposits in the Federal Reserve Banks.

4. The Council would appreciate any information the Board has regarding developments that may have occurred since the last meeting of the Board and the Council in connection with the Bank Holding Company bill.

The Council convened in the Board Room of the Federal Reserve Building at 2 P.M. on November 17, 1947, to hear J. Burke Knapp, Assistant Director of The Division of Research and Statistics of the Federal Reserve System.

All members of the Council were present except Mr. Ed H. Winton.

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E. E. Brown presents J. Burke Knapp who speaks on the subject of "Certain Aspects of the European Recovery Program". A summary of Mr. Knapp's remarks follows:

1. Internal Financial Reform in European Countries

It is generally recognized that as one means of self-help under the European Recovery Program countries receiving aid from the United States should undertake to stabilize their internal monetary situation.

In the minds of the Europeans, great emphasis is placed upon budgetary reform. Many of the European countries, notably France and Italy, have suffered chronic budget deficits since the end of the war, although at the present time they are making vigorous efforts to attain balance, at least in their "ordinary" budgets. In view of the high level of reconstruction expenditures, and the low level of taxable capacity as long as national income is not revived, they will find great difficulty in covering their "extra-ordinary" (or capital) budgets out of current revenues. Nonetheless, the inflationary effect of uncovered public expenditures is fully recognized, and this particular problem is on the way to solution.

Less clearly appreciated is the problem of over-investment in European countries, i.e. the tendency of these countries to plan capital investment programs which, together with current consumption, impose an undue burden upon their economies and cause resort to inflationary credit expansion in the "private sector" of the economy. It is very difficult for these countries to forego investment of a productive nature which promises to generate output which would increase consumption levels and help balance their international payments. However, monetary stability cannot be achieved unless the investment program is confined within the limits which can be met from the voluntary savings of the public.

It should be noted that both in the case of budgetary balance and in the case of the general level of consumption and investment, foreign aid, whether provided on a grant or loan basis, makes an important deflationary (or counter-inflationary) contribution. Without foreign aid, these countries would find it vastly more difficult to attain internal financial equilibrium.

Even if the foregoing problems were dealt with, there remains the question of the "monetary over-hang", i.e. the excessive supply of money inherited from the financing of war or occupation expenditures during the war period. Some of the smaller countries like Belgium and the Netherlands dealt with this problem in a resolute manner after liberation through blocking bank deposits and currency holdings, and subsequently by capital levies. However, France and Italy, although they have flirted with such plans, have never introduced them, largely because of hostility to such measures by the peasants who hold a large part of the excess currency supply. This problem of monetary over-hang is extremely important in Germany, where proposals for dealing with it have been prepared but have not been put in effect pending decision as to the economic unity of the country. The problem is also important in England, but no serious plans appear to have been made to deal with it there.

It should be noted that while some countries have suffered from "open" inflation characterized by rapidly rising prices, others (notably Germany and the United Kingdom) have succeeded in maintaining price controls in the face of excessive money supply. This state of "suppressed" inflation, however, is very damaging to the economy, as can be most clearly seen in Germany. It is our view that the British have been too complacent on this subject.

While the United States must refrain on political grounds from dictating in detail to European countries concerning their internal fiscal reforms, we must assert our interest in this subject, since the extent of foreign aid which is required may depend upon the extent to which corrective measures are taken in this field. This is therefore a matter upon which general undertakings will be requested from the recipient countries and to which the Administrator of the aid program must pay continuing attention as the program proceeds. He should always have the right to curtail or withhold assistance if recipient countries are unreasonably negligent in dealing with their internal financial and monetary problems. Incidentally, it is important for us to set the proper example by taking remedial measures in Germany as soon as the political situation there is clarified (presumably the results of the London Meeting of the Foreign Ministers will determine whether Germany is to be treated as an economic unit or whether the western zones of Germany are to be reorganized separately).

2. Local Currency Equivalent of United States Aid

As one direct method of asserting United States control over the domestic fiscal policy of recipient countries various suggestions have been made for impounding in special accounts the local currency equivalent of U.S. aid furnished on a grant basis. From an economic point of view, similar treatment might be requested for the local currency equivalent of aid furnished on reimbursable terms, but (a) in general it is the countries which will be receiving grants which have the worst internal financial disorders, and (b) if a country does accept an outright dollar obligation in return for aid rendered, it scarcely seems feasible to request in addition that that country pay the local currency equivalent into impounded accounts.

(Note that this discussion is confined to the question of employing U.S. control over local currency as a device for controlling domestic fiscal policy; it does not cover the use of local currency device for obtaining repayment, since the assumption is made at the outset that U.S. aid in these cases is to be extended as a grant.)

The main question at the moment is whether the local currency equivalent of U.S. aid furnished on a grant basis should simply be deposited in a special account of the local government, with a U.S. veto over its use for domestic budgetary purposes, or whether the United States should take title to this currency and assume the initiative in determining how the currency shall be used within the country concerned. As an example of the second type of proposal, Congressman Herter is suggesting that the United States might use such local currency funds to provide debenture capital for local industries whose expansion was deemed desirable in the interests of recovery.

In general, it is felt within the Government that the first type of procedure is as far as we should go. The exercise of a U.S. veto should provide a sufficient safeguard for U.S. interests while not creating undue political difficulties in the foreign countries. The second type of procedure would involve a much greater degree of U.S. intervention in the domestic affairs of the country and would involve assuming responsibilities which might prove very embarrassing. This latter remark is especially applicable to Congressman Herter's proposal which would subject the United States to all kinds of political pressures from different interested groups in the country concerned who would be seeking a share of the great "slush fund" which the United States would be supplying.

In general it should be recognized that U.S. control over the local currency equivalent of U.S. aid has serious limits as a means for influencing domestic fiscal policy. The local government concerned can always circumvent this control by other fiscal measures. For example, even if we insisted on permanently impounding the local currency concerned with a view to bringing deflationary pressure to bear upon the country concerned, the local government could engage in other forms of inflationary finance (e.g. borrowing from the central bank to finance government expenditures) which would frustrate United States intentions. Nonetheless, United States control over the local currency proceeds of U.S. aid would deprive the government concerned of large amounts of "easy money" and would bring real pressure to bear upon it. Furthermore, if the local government sought to circumvent U.S. control by outright inflationary finance, it would be violating its general pledge to restore sound financial practices.

3. Currency Stabilization Loans to European Countries

In the Paris Report, the European countries indicated that in addition to balance of payments assistance they might need up to 3 billion dollars to restore their monetary reserves to the level necessary to inspire public confidence in their currencies. From subsequent conversations with delegates at the Paris Conference, it appears that this supplementary assistance would be desired primarily in the form of gold and that stabilization assistance is needed primarily for psychological purposes. Many of the countries concerned have already drawn down their gold reserves to an extremely low level, and they feel that the task of internal monetary reform is greatly handicapped by the absence of some solid "backing" for their currencies. They are not asking for monetary reserves to be used for settled balance of payments deficits; what they really want is a "show piece" in their central bank returns.

The provision of such stabilization assistance is a function which is not well suited to the International Bank, despite the fact that at the request of the U.S. Congress in the Bretton Woods Agreements Act the Bank issued an interpretation of its charter indicating that it was competent to make "long-term stabilization loans". In using this phrase, both the Congress and the Bank apparently had in mind general-purpose loans for the stabilization of a country's balance of payments as distinguished from loans to finance specific capital projects. In any case, the Bank, with an eye upon the reaction of U.S. investors in its obligations, is anxious to confine its activities so far as possible to the financing of definable reconstruction and development projects.

Neither is this a function suited to the International Monetary Fund, although the Harriman Committee has suggested that the Fund might handle the problem. The International Monetary Fund was established to make short-term loans for the purpose of stabilizing a country's balance of payments and its exchange rate; provisions of the Fund Agreement specifically prevent a country from using the Fund's resources to build up its independent monetary reserves. It is again reiterated that what the European countries want is not temporary balance of payments assistance, but rather long-term loans for the purpose of reconstituting on a permanent basis their depleted monetary reserves.

From the point of view of the United States, it should be pointed out that loans in the form of gold would be costless to the U.S. economy, and even to the U.S. Treasury in the budgetary sense, if in fact the gold continued to be held in foreign monetary reserves. The U.S. economy would not be called upon to supply any goods, but only gold from our present more than adequate stocks. From the budgetary point of view, there would clearly be no cost to the Treasury to the extent that gold now held in the Treasury General Fund was used for this purpose; even if it were necessary to use gold now pledged against gold certificates (i.e. even if the Treasury had to issue interest-bearing securities to the Federal Reserve Banks in order to retire a portion of the gold certificates now held by those Banks) there would be no real cost to the Treasury since the interest charge it paid on such securities would be returned to the Treasury in the form of excess earnings from the Federal Reserve Banks.

The question remains of whether there is any real purpose to be served by currency stabilization loans. It has been asserted that either such loans are made before stabilization has been accomplished in the country concerned, in which case the proceeds of the loan are sure to be dissipated; or the loan is made after stabilization has been accomplished, in which case it is unnecessary. However, this may not be a true dilemma. A stabilization loan can be effective if it is granted at the moment when, with the loan, public confidence will be restored and stabilization will be assured, while without the loan, the stabilization effort would fail because public confidence was not forthcoming. Obviously the timing of such a loan is crucial to its success and involves very delicate judgment as to public psychology.

4. Exchange Rates in European Countries

It is clear that a number of European exchange rates are more or less seriously out of line with long-term equilibrium rates, and that sooner or later devaluations will be necessary if internal and external stabilization is to be achieved. The International Monetary Fund reviewed European exchange rates at the beginning of this year and decided that the time was not ripe for insisting upon changes in the existing rates. Many of the European countries whose rates seemed out of line put up very persuasive arguments to the effect that devaluation would not improve their international trade position. They pointed out that the classical effects of exchange depreciation would not work in present circumstances. Depreciation would not reduce their demand for imports, since they were already limiting imports to the minimum essential requirements; on the other hand, depreciation would not increase the foreign exchange value of their exports since they were already exporting as much as they could physically spare and since in the sellers' market prevailing at that time price considerations were no serious deterrent to their exports.

While there was much truth in these arguments, another consideration was very important, namely that devaluation has a strong initial inflationary impact which would greatly handicap the efforts of these countries to stabilize their domestic price levels. Devaluation means an automatic increase in import and export prices in terms of the local currency, and stimulates inflationary psychology. The European countries have therefore desired to defer the act of devaluation, if possible, until their internal financial reforms were sufficiently far advanced to withstand this new shock.

As matters now stand, many countries have made substantial progress in controlling domestic inflationary tendencies, and at the same time some of them are finding their over-valued exchange rates to be a serious deterrent to exports; hence it is likely that action will soon be taken by some of the countries concerned. Clearly the United States, acting so far as possible through the International Monetary Fund, which has been set up to assume responsibilities in this field, should encourage and even insist upon adjustments which are necessary to remove unjustifiable deterrents to exports. If this is not done, the country concerned will be relying unduly upon United States aid.

While it would be desirable in principle to readjust the whole European exchange rate structure at one time, it seems unlikely that this would be possible. Different countries will arrive at different times at the point where exchange rate adjustments are necessary, and while each country will be affected by the actions of others, it may be necessary to secure the general readjustment through consecutive steps rather than by simultaneous action (in reply to a question, the speaker stated that he had seen no compelling evidence for a devaluation of the pound sterling, especially in view of the recent rise in prices in the United States, the continuing firm grip of the British on their domestic price and wage structure, and the relationship of British prices and costs to those in most of the European countries).

5. The Question of Whether United States Aid should be Extended in the Form of Grants or in the Form of Loans.

Ideally this question should be approached solely in terms of the capacity of the foreign country to accept the burden of repayment, and possibly in terms of the adjustments which the United States would have to make in its own balance of payments in order to accept repayment. However, on political and practical grounds it has been proposed in various quarters that the distinction be made on the basis of the types of commodities which are supplied under the aid program, in particular that such "unproductive" commodities as food, fuel, and fertilizer might be supplied as grants while "productive" items such as raw materials and capital equipment might be supplied under long-term loans.

There are a number of serious limitations to this commodity approach. In the first place, it may be questioned whether this distinction between "productive" and "unproductive" commodities is generally valid. It can be argued that food and fuel are just as "productive" to a capital goods manufacturing country like the United Kingdom, as capital equipment is to a country like Greece. Similarly, the application of fertilizer constitutes an investment in the soil which may be just as "productive" as the use of farm machinery.

Even if the distinction were accepted, the fact remains that the contribution by a given amount of imported goods to a country's repayment capacity by no means measures that country's capacity to pay for the goods. A judgment on this question must take into account other immensely more important factors in the country's over-all balance of payments and international financial position. Obviously there are European countries which are quite capable of repaying loans even if the proceeds are used to import goods for unproductive consumption purposes. Equally obviously there may be some countries which, even allowing for the increased productivity following upon the import of capital goods, would be unable to accept the burden of paying for such goods.

Finally, having in mind that any country to which aid is extended will always have some dollar resources from exports or otherwise in addition to the aid program, it is apparent that the selection of the particular portion of the country's import program to be financed by the United States is necessarily a more or less arbitrary matter. It cannot therefore be such a simple matter as saying that a country needs food and therefore should get a grant, or that it needs capital equipment and therefore should be given a loan.

Nonetheless, the "commodity approach" remains useful in two respects:

(a) To the extent that firm judgments can be made as to the capacity of a country to repay, this criterion should be used to determine whether the country is to get a loan or a grant. However, if it is to be a loan, there are definite psychological advantages in picking out the capital equipment portions of the country's import program for financing by the loan, letting it use its own resources if possible to cover its other "unproductive" import requirements. Among other things, the government and public in the country concerned may be more prepared to maintain service on the loan in the future if the proceeds have been spent upon capital goods which remain in existence to bear witness of the U. S. contribution. On the other hand, if it is to be a grant, there are corresponding psychological advantages in picking out the food, fuel, etc., elements in the country's import program for financing through the grant, leaving the country concerned to finance its other import requirements out of its own resources.

(b) There may be many marginal cases in which it will simply not be possible to arrive at firm judgments as to a country's capacity to repay. In such cases one might rely on the rule of thumb formula based upon the nature of the commodities delivered under the aid program, although the question will still remain of how to make the allocation between the imports to be financed by the aid program and the imports to be financed from the recipient country's other resources.

6. <u>"Off-shore Purchases"</u>

An important policy question in connection with financing the European Recovery Program is the extent to which the United States should finance purchases by the European countries in third countries, especially in the Western Hemisphere (such purchases are referred to for convenience as "off-shore purchases").

It is argued in support for such purchases that they may reduce the strain on the U. S. economy. However, since the dollars spent abroad under such a program would probably be shortly respent in the United States, this argument is only valid if when the dollars are respent they fall upon goods which are in relatively abundant supply. Unfortunately, this may not always be true.

Even if it were true, the question remains of whether the third countries which are exporting to Europe should not finance their own surpluses, i.e., grant credits to Europe themselves rather than requiring the United States to "bail them out" through the provision of dollars. Looked at from this point of view, it would appear that the principal purpose of having the U. S. supply dollars for "off-shore purchases" would be to provide the countries in which the purchases are made with dollars needed by them to maintain essential imports from the United States. "Off-shore purchases" of this kind would in effect kill two birds with one stone; they would finance the needed flow of commodities to Europe as well as the essential imports from the U. S. of the countries in which purchases are made. A possible alternative to "off-shore purchases" which may be applicable to countries like Canada, is to let the countries concerned extend credit to Europe while on the other hand borrowing in the United States to meet their essential dollar needs.

Clearly the United States, in view of its major interest in the European Recovery Program, must join the European countries in negotiating reasonable terms of sale and of finance in connection with European procurement in other countries of this Hemisphere.

The meeting adjourned at 5:00 p.m.

The Council convened in the Board Room of
the Federal Reserve Building at 9:30 A.M.
on November 18, 1947.

All members of the Council were present
except Mr. Ed H. Winton.

The Council prepared and approved the following statement which is to be presented to the Board of Governors at the joint meeting with the Board at 10:30 A.M. today. The statement is to be given to the Board in connection with and in addition to the Council's statement on point 2 of the agenda for the joint meeting of the Board and the Council at 10:30 A.M. today:

Suggestions in the President's message to Congress with respect to credit control indicate the possibility that the Federal Reserve Board may present to Congress the proposal in its 1945 Annual Report for a required bank reserve of short term government securities. The Council therefore wishes to state its views on this proposal.

The proposal as we understand it is that banks should be required by law to maintain, in addition to cash reserves, reserves of short term government securities in a percentage relationship to deposits, to be fixed from time to time by the Federal Reserve Board.

The Council is unanimously opposed to this scheme for the following reasons:

1. It is impractical. The operations of banks are so different, reflecting as they do adaptation to the varying needs of their communities and customers, that no percentage of short term government security holdings can be applied fairly or practically to all banks. Any percentage high enough to offer any measure of restraint on a substantial number of banks will have disastrous effects on many other banks, compelling them to liquidate sound and necessary loans and thus actually check production. The very banks which have served the business in their communities most aggressively and helpfully would be hardest hit.

2. Such a plan would substitute the edicts of a board in Washington for the judgments of the boards of directors of 15,000 banks throughout the country as to the employment of a substantial part of the funds of their banks. This is a step towards socialization of banking.

3. As indicated earlier, the Federal Reserve System and the Treasury already possess large powers of credit control not now being fully used. Such new powers as those proposed are not necessary.

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The meeting adjourned at 10:20 A.M.

On November 18, 1947, at 10:40 A.M., the Federal Advisory 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 Mr. Ed H. Winton.

The following members of the Board of Governors were present: Chairman Eccles; Governors Szymczak, Draper, Evans, Vardaman and Clayton; also, Mr. Carpenter, Secretary of the Board of Governors.

WHAT POSITION DOES THE COUNCIL WISH TO TAKE NOW ON BILL S.408?

E. E. Brown states that at the September meeting of the Council and Board, the Chairman of the Board of Governors asked the Council not to go on record on Bill S.408 until the following joint meeting of the Council and the Board in November. Brown says the Council is cognizant of the investigation of the activities and powers of the Reconstruction Finance Corporation now being made by a Congressional Committee. Until Congress has determined whether the Reconstruction Finance Corporation should be continued, and, if continued, what powers to make or guarantee loans should be given it, the Council feels that no action by Congress should be taken on Senate Bill 408. The Council feels that Senate Bill 408 should be considered only as an alternative to legislation continuing the present loan and guarantee powers of the Reconstruction Finance Corporation. If the Congress should decide to continue the Reconstruction Finance Corporation without greatly curtailing its loan and guaranteeing powers, the Council would be opposed to the passage of Senate Bill 408. The majority of the Council would prefer Senate Bill 408 to the continuation of the Reconstruction Finance Corporation powers, but it should also be noted that a minority of the Council is against giving any guarantee or commitment powers to the Federal Reserve Banks under any circumstances, as proposed in Senate Bill 408.

Eccles says that the Council's viewpoint is agreeable to the Board, especially since it shows a preference for Senate Bill 408 compared to the continuation of the powers of the Reconstruction Finance Corporation.

THE BOARD IS VERY MUCH CONCERNED ABOUT THE RAPID EXPANSION OF BANK CREDIT. THE BOARD, THEREFORE, DESIRES TO HAVE THE VIEWS OF THE COUNCIL AS TO THE FURTHER STEPS THAT MIGHT BE TAKEN TO CORRECT THIS SERIOUS SITUATION THROUGH MONETARY OR FISCAL MEANS.

E. E. Brown reads the statement which the Council made on this item in its confidential memorandum to the Board of Governors yesterday, a copy of which memorandum is a part of these minutes. Brown says that since this statement was prepared the Council has heard the President's message to Congress, and the Council has prepared the following additional statement which it desires to add to the statement prepared and submitted to the Board yesterday on this item in the agenda:

Suggestions in the President's message to Congress with respect to credit control indicate the possibility that the Federal Reserve Board may present to Congress the proposal in its 1945 Annual Report for a required bank reserve of short term government securities. The Council therefore wishes to state its views on this proposal.

The proposal as we understand it is that banks should be required by law to maintain, in addition to cash reserves, reserves of short term government securities in a percentage relationship to deposits, to be fixed from time to time by the Federal Reserve Board.

The Council is unanimously opposed to this scheme for the following reasons:

1. It is impractical. The operations of banks are so different, reflecting as they do adaptation to the varying needs of their communities and customers, that no percentage of short term government security holdings can be applied fairly or practically to all banks. Any percentage high enough to offer any measure of restraint on a substantial number of banks will have disastrous effects on many other banks, compelling them to liquidate sound and necessary loans and thus actually check production. The very banks which have served the business in their communities most aggressively and helpfully would be hardest hit.

2. Such a plan would substitute the edicts of a board in Washington for the judgments of the boards of directors of 15,000 banks throughout the country as to the employment of a substantial part of the funds of their banks. This is a step towards socialization of banking.

3. As indicated earlier, the Federal Reserve System and the Treasury already possess large powers of credit control not now being fully used. Such new powers as those proposed are not necessary.

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Brown advises the Board that the Council would like its answer to point two of the agenda to be submitted by the Chairman of the Board of Governors to the proper committees of Congress.

Eccles replies that Senator Taft called him yesterday and Eccles is to appear before the joint committees of Congress very shortly, perhaps in the next few days. He will be glad to present the statement of the Council to the Congressional committees.

E. E. Brown. A raise of 1/4 per cent or of 1/2 per cent in the rediscount rate would have an important effect on the economy, as bankers and businessmen are more jittery now. Open market operations constitute another power which the Board can use. In addition, the government war loan accounts are larger than they need to be. The withdrawal of funds from the war loan accounts has a cumulative effect on the banks. Brown also believes that an increase in the reserve requirements to 26 per cent in New York City and Chicago should also go into effect before new powers are sought by the Board.

Eccles. There are two methods - monetary and fiscal - of dealing with the present situation, aside from the direct control of credit. During the war the accepted methods of controlling credit could not be used. Taxes were raised as high as possible. It was finally felt that no more revenue could be obtained by taxes. Consequently, deficit financing took place, and deficit financing through banks is inflationary. Thus, the fiscal policy was inflationary. Second, monetary policy was inflationary. The sale of securities to the public, which later went to the banks, was not what the Board felt should have been done. The banks liked to play the pattern of rates, and favored these policies. Direct credit controls are the only adequate substitute for monetary and fiscal policies. But most bankers and the public do not like direct credit controls. A budgetary surplus is the only major anti-inflationary fiscal policy. This surplus is used to retire bank-held debt, and so it is anti-inflationary, which is contrary to the inflationary policy of putting bonds into the banks during the war. Treasury balances have been used to retire the debt. It is difficult actually to reduce Government expense. But the greater the budgetary surplus, the larger the reduction which can be made in the bank-held debt. With Europe probably getting five billion dollars next year, and with a tax cut, the surplus will be very small. The impact of fiscal policy will not be very effective. Fiscal policy is three times as valuable as monetary policy. We need large, very large, budgetary surpluses. We shall need monetary and credit policies, especially if there is a further expansion of bank credit. The problem today is the shortage of labor and raw materials, and it is not a shortage of bank credit. The Council lists such matters as a shorter working week as factors in the inflation, but the Board is not concerned with hours of labor and other factors of this nature. The Board wishes to know from the Council what monetary and fiscal policies the Board should follow with the present inflationary situation. Eccles states that labor can work over forty hours a week, but it gets 1-1/2 times its regular rate over forty hours.

Fleming disagrees with Eccles that labor can and will work over forty hours per week, and he cites a situation in Washington.

Eccles thinks the cases where labor cannot and will not work over forty hours a week are exceptional. The Republican Congress was hopeful last year that it could cut expenses, but its achievements were not very impressive. The items of military expense, interest on the debt and veterans' costs are relatively fixed. The foreign relief program may even be increased, and so you have thirty-two or thirty-three billion dollars without adding public roads, flood control and similar items. Congress will not do away with agricultural subsidies. We know that paying the soldiers' bonds was undesirable, but there were no votes in Congress against it. As a result, we have to consider monetary and fiscal policies. If we have no further increase in the money in circulation and in deposits, given even a normal velocity of circulation, we have a dangerous situation if more credit is added. Wage increases, profit increases, and price increases bring demands for more credit. Eccles reads the following quotation from page 130 of the Monthly Letter for November of The National City Bank of New York: "Rapidly accumulating debt is both a cause and a consequence of the inflationary pressures, for in a wage-price spiral, business constantly needs more and more money to keep going and this leads to the incurrence of more and more debt by business and more and more spending by the individual. To check this kind of spiralling—which is to the ultimate benefit of no one and to the injury of all—is not simple." Increased wages are inflationary; so is increased credit. As prices have gone up, banks have added more credit to the situation. Somewhere this trend must be stopped. It is not logical to try to stop this situation everywhere but in bank credit. The Federal Advisory Council states that: "For the past year the total volume of bank credit (i.e., the available amount of bank money) as measured by adjusted demand deposits has been practically level. As bank loans have increased, the banks have decreased their investments." Eccles states that this is not correct. As shown on the attached table and charts (which Eccles has), which are being published in the November Federal Reserve Bulletin, total deposits and currency held by individuals and businesses (excluding U. S. Government and interbank deposits) increased by 5.5 billion dollars in the 12 months ending September 30. In the third quarter of 1947 this increase was 2.3 billion dollars, or an annual rate of over 9 billion dollars. The principal factors accounting for this growth in bank credit were an expansion of bank loans in the 12-month period of 7 billion dollars and an inflow in gold of 2.7 billion dollars. Banks, including Federal Reserve and mutual savings banks, reduced their holdings of Government securities by nearly 11 billion dollars, but at the same time there was a decrease in U. S. Government deposits of nearly 8 billion dollars. During the third quarter of 1947 the large loan expansion of 2.3 billion dollars was the principal factor accounting for the further growth in deposits. The Council's statement is apparently based upon figures for weekly reporting member banks, which have shown only a moderate increase in demand deposits adjusted during the last four or five months following a sharp increase in the second quarter of the year. In recent months, however, deposits at country member banks, and no doubt also at nonmember banks, have increased sharply, reflecting a seasonal flow of funds to agricultural regions which has been particularly great this year because of the high prices of farm products. City banks have contributed to the overall growth in deposits by the sharp increase of over 2.5 billion dollars in their loans since June. They have been able to increase these loans in part because of the gold inflow and in part because of an increase in interbank balances, as well as through a decline of about a billion dollars in their holdings of U. S. Government securities. So it is not true, even in the case of city banks, as is implied in the Council's statement, that banks have decreased their investments corresponding to the increase in loans. Eccles says the Board agrees that the credit available for housing has been excessive. The bankers have had a hand in it. The cost of housing has gone up 20 per cent in the last year. The bankers need to be restrained in their real estate loans. The banks may not make consumer loans, but they loan businesses and finance companies that do. Eccles reports that he has talked with Wiggins, Clark, and Foley about the possibility of getting some control over the mortgage situation. He thinks those that are administering veterans' activities need not be so aggressive. He feels that Title VI, which has run out, should not be renewed and he says that Board would welcome the help of the Council in preventing its renewal.

Burgess thinks it would be helpful if the Council and the Board could prepare a statement on Title VI showing the Board and the Council in agreement.

Eccles says that the banks are making more FHA loans than anyone else. There should be less pressure to make veterans' real estate loans, and Title VI should be eliminated.

Burgess asks whether the Board has prepared any written statement on this matter.

Eccles replies that the Board has not prepared a written statement, but that it has been largely a matter of discussion. He says that the Board may work out a statement on these matters and submit it to the Executive Committee of the Council or some special committee of the Council for consideration.

Burgess suggests that when Eccles talks with the Congressional Committees he may wish to state that the Council has mentioned these matters.

Eccles. The reason there is inflation in housing is that we are trying to get adequate housing over night. If we had a depression with five to ten million persons unemployed and with national income down 25 per cent, the housing shortage would disappear over night.

Odlin believes that the Council's interest is in commercial loans and he thinks the banks are doing a legitimate and constructive job in making sound loans for productive purposes.

Eccles. If prices go up 25 per cent, bank loans go up 25 per cent. If prices go up 50 per cent, bank credit goes up 50 per cent. Consequently, banks are supporting the inflationary spiral by bank credit. Eccles thinks the Council should change its statement on point 2 of the agenda, if the Council wishes to priht it. The PCA gets its funds largely from the banks. As long as the parity program is continued, the CCC will continue.

Fleming. All these steps stem from Government policies which the banks are asked to support, and the banks would be criticized if they did not support them.

Szymczak. The banks are not being blamed for the inflation.

Burgess. The President in his message placed bank credit near the top of the causes of inflation.

Fleming. What can a banker say to a good customer who wishes a loan and whose labor and inventory costs are up so that he needs funds? Should the bank refuse the loan?

Eccles does not blame the banks. No individual bank can be criticised for taking care of its customers on sound loans. 70 per cent of the bank deposits have represented Government securities. The opposite side of Government securities on the bank statement is deposits. The great increase in deposits developed as a result of the financing of the war. The Federal Reserve System must be ready to buy any bonds the banks sell. Every time a bank sells $1 in Government bonds it can expand its credit by $6 or $7. The banks can sell ten billions of their Government bonds, or about one-seventh of their total Government bond holdings, and expand credit seventy billion dollars. There is nothing the Board of Governors can do to stop it. There should be some way of curbing or stopping this development. The Board is not critical of any bank or of the banking system in its operations.

Fleming hopes that Eccles will state that he is not critical of banks or the banking system if he is called upon to testify before a Congressional committee.

Eccles states he is a practical banker, has had a great deal of experience and knows the inside of banking. He says competition is exceedingly keen, and, with so many banks, bank credit will not be restricted. The banks should not be criticised, and the only criticism that may be made is that banks are permitted to have access to billions of dollars of government credit. This credit is available to them, and they should not be blamed for using the credit. Eccles states that the Council maintains the Board has the powers it needs, but he insists that the Board does not have the necessary powers. He says the short term and long term rates must be supported. The short term rate has been permitted to rise and it was felt desirable to bring long term security prices down so the rate would be nearer 2-1/2 per cent rather than 2-1/4 per cent or less. To get the long term rate up, the short term rate has been permitted to rise. The Board suggested to the Treasury that a 2-1/2 per cent, non-marketable bond be issued, and the Treasury agreed. The Treasury would not have agreed to let the bill rate go up unless the Treasury got back the increased earnings the Federal Reserve System received, and this was arranged. The basic reason for letting the short term rate go up is gone now. The long term securities are now being supported. Eccles states that the recent rise in the yield on corporates has been due to the corporate demand for capital and not to the fact that the short term government rate has been permitted to rise. The amount of private corporate financing is tremendous, and Eccles believes the rates for such financing are going up. He thinks that the purchases of E and G bonds by the public may not be larger than the amount of these bonds which will be cashed. There may also be selling of long term bonds. To raise the short term rate further at present is unnecessary. No one believes a raise in the rates of private credit from 1-1/2 to 1-3/4 or 2 per cent will deter private borrowers. Consequently, raising the short term rate one-half of one per cent would be meaningless as a method of restricting credit. Raising the short term rate further has no argument in its favor. The gold imports (at the rate now of about $3 billion dollars a year) and the purchase by the Federal Reserve banks of long term government bonds from the banks are inflationary, as they provide means of increasing bank credit. Eccles states they will not sterilize the gold because sterilization would affect the budget. Eccles thinks the rediscount rate should be raised to 1-1/4 per cent, but Sproul disagrees.

Fleming thinks the rediscount rate should be a penalty rate.

Eccles agrees.

E. E. Brown believes an increase in the rediscount rate would have a significant psychological effect and lead to the determent of expenditures, particularly by large borrowers. During the last sixty days large borrowers have tended to be more hesitant.

Eccles. The increased cost of long term money is a major factor in making borrowers hesitant.

E. E. Brown thinks the long term rate is not as important a factor as the inability to do equity financing.

Eccles. The stock market is the soundest part of the economy.

Burgess. Sound? It's dead.

Eccles. If the Board's proposal went into effect, the rediscount rate could be raised to 1-1/2 per cent or 2 per cent. Under the Board's proposal, the banks could hold the increased reserves required in cash, deposits with the Federal Reserve banks, inter-bank deposits, or short term paper (notes, bills, and certificates up to a two year maturity). The banks would have authority to invest in short term paper, up to two years maturity, but this would not include bonds. The tendency would be to raise short term rates on business paper.

Fleming asks whether the Board has determined the exact percentage of the special reserve which would be required in the Board's proposal.

Eccles says the Board may ask for authority to go as high as 25 per cent over and above the present requirements. This figure would apply to the demand deposits. The Board may ask for 10 per cent on time deposits above the present requirements. With gold coming into the banking system, and if banks sold long term governments, the tendency would be to use the funds to buy short term securities.

Burgess asks how long a period the banks would be given to comply.

Eccles states that after the first 10 per cent, the requirement would probably be increased only 5 per cent at a time, with perhaps a notice of sixty days. In general, it might work out that banks would then divide their assets about as follows: 25 per cent in cash; 25 per cent in short term government obligations; 25 per cent in other government securities; and 25 per cent in loans. The 25 per cent increase in reserve requirements would fairly well absorb the bills and certificates. The authority for requiring this increased reserve would be asked for a period of only three years as an anti-inflationary measure. The Open Market Committee would be given the authority to administer the proposal. Eccles then reads part of a long statement which he indicates is the statement he may present to the proper Congressional Committees. As soon as he has presented the statement, the Secretary of the Board of Governors will send a copy to each member of the Council. Eccles states that the Board has no power to prevent the inflow of gold from expanding credit, and the Board has no power either to prevent banks from selling bonds which Federal Reserve banks find it necessary to buy. Eccles states that if the reserve requirements of central reserve cities were increased to 26 per cent, it would simply result in the central reserve city banks selling approximately $1-1/4 billion in government securities to the Federal Reserve banks. These member banks would then lose earnings and the Federal Reserve banks would receive the earnings. The loss in earnings to the member banks might result in those banks making more loans. The Federal Reserve System is unable to sell bonds to the market to take up reserves resulting from the gold inflow and from the sale of bonds by banks. If the Board's proposal became effective, it would make it possible to hold down the interest cost of the debt to the government, and at the same time it would result in higher rates to private borrowers at banks. The increased yield on corporate obligations is resulting in the sale, by the holders, of long term governments and is making it necessary for Federal Reserve banks to buy the bonds. Eccles listed the following as some of the principal features of the Board's proposal: (1) power would be limited to a three year period. (later, at luncheon, Eccles indicated that the power would necessarily have to be extended if the inflationary conditions continued more than three years). (2) it would apply to all banks, member and non-member, insured and non-insured, but it would not apply to purely savings banks; (3) it would apply to all deposits, including government deposits, but would be higher on demand deposits; (4) there would be an allowance for certain items in figuring the reserves required, and it is contemplated that correspondent bank relationships would not be disturbed. (5) Treasury bills, certificates of indebtedness and notes with a maturity of not over two years would be eligible for the special reserve; (6) the special reserve would be fixed at a maximum of 25 per cent of the gross demand deposits and 10 per cent of the time deposits, with notice of a certain period to be given before increasing the special reserves, from time to time, within these limits; (7) gold movements, currency fluctuations, conditions in the general security market, and general credit conditions in the country would be among the factors determining the amount of special reserves to be requested; (8) the reserves would be determined on a monthly basis;

(9) the penalty would be 1/2 of one per cent a month on a deficiency in the reserves; (10) the administration of this measure for non-member banks would be in the hands of other agencies, such as the F.D.I.C. for non-member insured banks and State bank commissioners for the uninsured non-member banks; (11) the special reserve requirements would prevent banks from acquiring reserves from the inflow of gold and the sale of government bonds which reserves might be used to expand credit. (The System would support the 2-1/2's so they would not sell below par). The proposal would prevent the multiple expansion of credit now taking place through gold imports and the sale of government securities by banks; (12) the major effect would be to reduce the ready availability which bank borrowers have to bank credit, and it would increase the rates to private borrowers.

Burgess asks Eccles if he will send copies of his testimony before Congress to the members of the Council.

Eccles agrees.

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(The meeting adjourned at 1:30 P.M. for luncheon and reconvened at 2:35 P.M. in the Board Room).

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Eccles wishes the Council would rewrite its statement on point 2 of the agenda, which included the additional statement of the Council on the proposal of the Federal Reserve Board in its 1945 Annual Report regarding a required bank reserve of short term government securities.

Eccles does not believe the powers the Council mentions in its statement are important powers.

Draper also asks whether the Council would not rewrite its statement somewhat.

E. E. Brown says that one of the difficulties is that Congress may wish to act quickly. (The action of the Council regarding the request made by Eccles may be noted at the end of these minutes).

THERE IS AN OBLIGATION RESTING UPON THE FEDERAL RESERVE SYSTEM CONSTANTLY TO IMPROVE AND EXPEDITE CHECK COLLECTION PROCESSES FOR THE BENEFIT OF INDUSTRY, AGRICULTURE AND COMMERCE. A CONSTRUCTIVE MOVE IN THIS DIRECTION IS INDICATED IN RECENT CORRESPONDENCE BETWEEN THE PRESIDENT OF THE RESERVE CITY BANKERS ASSOCIATION AND THE CHAIRMAN OF THE BOARD OF GOVERNORS, COPIES OF WHICH ARE ATTACHED. THE BOARD WOULD APPRECIATE AN EXPRESSION OF THE VIEWS OF THE COUNCIL AS TO HOW BEST TO PROMOTE AND ADVANCE THE MODERNIZATION AND MAXIMUM DEVELOPMENT OF THE CHECK COLLECTION SYSTEM.

E. E. Brown reads the statement of the Council giving its conclusions regarding point three of the agenda. A copy of the Council's statement on point three will be found earlier in these minutes. Brown states that he understands there is some discussion about making all items available immediately. He mentions that the Federal Reserve Bank of Chicago makes available on Saturday, New York City items which would not be available until Monday because of the Saturday closing in New York City. Brown states that the Council believes any changes in the check collection process which result in making items available sooner, on the average, than the period required for their collection, are not sound.

Eccles replies that the Board disagrees with the Council in its viewpoint. Eccles says that he suggested to Julian Baird that the Association of Reserve City Bankers work through the Council as the Council is the statutory body representing all bankers. The Board does not believe it should deal with the Committee of the Association of Reserve City Bankers directly. The Board might find itself then in the position of having to deal directly with all the various committees of the American Bankers Association on various matters.

Eccles then quotes from page 17 of the 1915 Annual Report of the Federal Reserve Board as follows: "For many years it has been lawful for banks to count as reserves deposits with other banks. It was never the intention of the Federal Reserve Act that member banks should continue the maintenance of these reserve accounts. On the contrary, the full meaning of the Act is manifestly opposed to such an idea. It is the plain conception of the Act that the reserve banks should, to a very large extent, if not entirely, perform the work that is now being done by correspondent banks in this respect. This means that the reserve balances to be carried in the future by the reserve banks instead of by the correspondent banks should serve as the basis for a system of clearing and collecting the exchanges of the country. Whatever can be done to bring about the prompt and effective use of this new system of bank settlement will be done." Eccles states that the question of giving immediate availability is not unsound. It would make funds available sooner to banks, businesses and industries. The immediate availability of items would eliminate much analyzing of accounts. To induce non-members to join the System, they should be given more service. The Federal Reserve System cannot be operated to build up the reserve city banks at the expense of commerce, industry and agriculture. Immediate availability would be beneficial to reserve city bankers more than to any other group.

E. E. Brown calls attention to a new requirement on Chicago collections which may cost the banks a considerable amount.

Eccles replies that about sixty reserve city banks are dumping items into the Federal Reserve banks requiring sorting at large expense to the Federal Reserve banks, and the System wishes to stop this practice. The matter of what procedure to follow has not been definitely decided and the banks affected will have a chance to express their views.

E. E. Brown states that the banks would like to present their views on the matter and talk with the proper officials, perhaps the presidents of the Federal Reserve banks, on the matter.

THE COUNCIL WOULD APPRECIATE ANY INFORMATION THE BOARD HAS REGARDING DEVELOPMENTS THAT MAY HAVE OCCURRED SINCE THE LAST MEETING OF THE BOARD AND THE COUNCIL IN CONNECTION WITH THE BANK HOLDING COMPANY BILL.

E. E. Brown asks whether the Board has any information regarding recent developments in connection with the bank holding company bill.

Eccles replies that there is nothing new except that the Western group of Independent Bankers has passed a strong resolution favoring the bill, and the State Banking Commissioners, in their recent convention, also passed a resolution favoring the bill. He states that Senator Downey was able to prevent the bill being acted on in the Senate because time was short. The House is ready to act when the Senate acts. There may be one or two additional amendments but the bill reported out of the Senate is the bill as it may pass.

CONSUMER CREDIT

Eccles states that the bankers are losing their consumer credit loans quite rapidly. Merchants can extend consumer credit even without down payments because their profits enable them to take losses which the banks are not in a position to incur.

The meeting adjourned at 3:12 P.M.

The Council reconvened in the Board Room of the Federal Reserve Building at 3:15 P.M. on November 18, 1947. All members of the Council were present except Mr. Ed H. Winton.

E. E. Brown asks whether the Council wishes to change its statement on point 2 of the agenda.

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The subject for discussion under point 2 was submitted by the Board of Governors and read as follows: "The Board is very concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means." After discussing the matter, the Council approved the following statement, with one member present not voting, and requested that the statement be presented to the Chairman of the Board of Governors who was to be asked to submit the Council's statement to the proper committees of Congress at the time the Chairman of the Board of Governors testifies before these committees on these matters:

The Council has reviewed the question of the volume of bank credit both in the aggregate and as shown in the banks with which they are familiar.

We do not know what "serious situation" in bank credit the Board has in mind. For the past year the total volume of bank credit (i.e. the available amount of bank money) as measured by adjusted demand deposits has shown only a moderate increase. As bank loans have increased, the banks have decreased their investments.

We find nothing in bank loans themselves to suggest that growth of loans has been an active inflationary factor. It rather appears to have been a reflection of the very high level of business activity and high prices.

To a large extent growth of loans is a direct result of government policies. For example, an increase of nearly 4 billion dollars in the real estate loans by insured banks since the end of the war reflects directly the purchase of FHA and GI mortgages in the housing program.

The Reconstruction Finance Corporation is encouraging bank lending by guaranteeing risky loans.

Commercial loans are influenced by high prices and active movement of agricultural and manufactured products for the foreign aid program.

High wages and high costs of materials have meant that business needed more money to take care of its customers.

There is nothing in the figures or our experience to suggest that there exists any substantial lending for speculation or for unnecessary uses. Loans for carrying securities are much reduced.

In this period the government, through various agencies, has been making loans that the banks refrained from making because of their speculative nature. The Reserve System itself is asking for more power to guarantee loans on the presumption that bank lending is too cautious.

The causes of our present inflation are not in current banking policies but are found in the great war-time expansion of buying power together with unusual events and public policies since that time. Among recent inflationary causes may be listed the following:

The foreign aid program

A cycle of wage increases in excess of increases in either the cost of living or productivity

A shorter working week

A short corn crop

Veterans bonuses and relief payments

Agricultural price subsidies

U. S. Government spending of 36 billion dollars a year

Housing subsidies

In the face of these developments a substantial increase in bank loans was inevitable and the banks have shown restraint. The dangers in the present situation are understood by bankers and there is hardly a bank in the country which has not been warning its customers against over-expansion. The loans being made are mostly for direct production.

The first thing to do is to reconsider government policies which are inflationary and especially excessive government spending and subsidies.

We recognize that even though the causes of inflation are largely outside the sphere of monetary policy, the Reserve System has a special responsibility for bank credit and in this situation should take all reasonable care to assure conservative credit policies.

In this special area we suggest that the System and the Treasury already have large powers, without new legislation, to place credit under broad restraints.

One of these powers is the discount rate which is a recognized instrument for serving notice on the public of the need for restraint in the use of credit.

Similarly by open market operations the System can control the reserves of the member banks and limit their lending power.

The Board also still has the power to raise reserve requirements in Central Reserve Cities and so tighten money.

The Treasury by the pricing of new issues and the handling of its balances has great influence on the rate and volume of money.

In the past year the System and the Treasury have used these powers effectively.

The money markets and the policies of business men are today so sensitive to action of these sorts which the Reserve System and the Treasury take that present powers are ample to place all restraints on credit expansion which the System and the Treasury may consider necessary.

The Council wishes it clearly understood that it shares the apprehension of the Board of Governors with respect to inflation dangers. It does, however, most strenuously object to the singling out of the increase in bank loans as a principal contributing factor; and it has attempted to point out above, the vastly more important elements of inflation - of which bank loans are a barometer.

This is not to say that there have not been unwise bank loans in some cases. After all, banking is a form of human endeavor, operated by human beings. It would be amazing if there were not some errors in judgment. But we submit that, on the record, there is no evidence of bank credit expansion beyond that which could be expected under all the circumstances. There is every evidence that loans are today doing a wholesome and constructive work in their intended place in the economy.

The Council has studied the increase in consumer credit in relation to the termination of Regulation W. While consumer credit has increased substantially, much of this reflects the availability of automobiles and household appliances. There is so far too little experience on which to judge the effect of the termination of Regulation W. The American Bankers Association is undertaking with considerable success to ensure maintenance by banks of sound lending standards. This effort towards voluntary cooperation seems to the Council the sensible and the democratic method of dealing with this problem, both with respect to the banks and other lenders. The Council is opposed to legislation giving the Board new regulatory powers in this matter.

Suggestions in the President's message to Congress with respect to credit control indicate the possibility that the Federal Reserve Board may present to Congress the proposal in its 1945 Annual Report for a required bank reserve of short term government securities. The Council therefore wishes to state its views on this proposal.

The proposal as we understand it is that banks should be required by law to maintain, in addition to cash reserves, reserves of short term government securities in a percentage relationship to deposits, to be fixed from time to time by the Federal Reserve Board.

The Council is unanimously opposed to this scheme for the following reasons:

1. It is impractical. The operations of banks are so different, reflecting as they do adaptation to the varying needs of their communities and customers, that no percentage of short term government security holdings can be applied fairly or practically to all banks. Any percentage high enough to offer any measure of restraint on a substantial number of banks will have disastrous effects on many other banks, compelling them to liquidate sound and necessary loans and thus actually check production. The very banks which have served the business in their communities most aggressively and helpfully would be hardest hit.

2. Such a plan would substitute the edicts of a board in Washington for the judgments of the boards of directors of 15,000 banks throughout the country as to the employment of a substantial part of the funds of their banks. This is a step towards socialization of banking.

3. As indicated earlier, the Federal Reserve System and the Treasury already possess large powers of credit control not now being fully used. Such new powers as those proposed are not necessary.

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The meeting adjourned at 4:00 P.M.

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A copy of the statement was presented to the Chairman of the Board of Governors, and a copy was also presented to the Secretary of the Board of Governors, between 4:00 P.M. and 5:00 P.M., November 18, 1947, by Vice President Spencer and the Acting Secretary of the Council. The Chairman of the Board of Governors was asked to submit the Council's statement to the proper committees of Congress at the time the Chairman testifies before these committees on these matters.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
November 25, 1947

RELATION OF BANK CREDIT AND INFLATION

Reply by Board of Governors of the Federal Reserve System
to statement issued by Federal Advisory Council

The Federal Advisory Council, composed of one banker from each of the twelve Federal Reserve Districts designated under statutory authority to advise the Board of Governors of the Federal Reserve System, was recently asked by the Board for an expression of the Council's views as to the present credit situation. The Board stated that it "is very much concerned about the rapid expansion of bank credit. The Board, therefore, desires to have the views of the Council as to the further steps that might be taken to correct this serious situation through monetary or fiscal means."

The Council's reply, which has been released for publication by the Board and presented to Congress by the Chairman of the Board, states that the Council finds "nothing in bank loans themselves to suggest that growth of loans has been an active inflationary factor. It rather appears to have been a reflection of the very high level of business activity and high prices." While the Council shares the apprehension of the Board with respect to inflation dangers, it believes that "the causes of inflation are largely outside the sphere of monetary policy". Nevertheless it recognizes that "the Reserve System has a special responsibility for bank credit and in this situation should take all reasonable care to assure conservative credit policies." The Council expresses the view that in this special area present powers are ample, without new legislation, to place all restraints on credit expansion which the System and the Treasury may consider necessary.

Recent credit expansion

The rapid expansion of bank credit, about which the Board is concerned, is indicated by the growth of bank deposits held by businesses and individuals at all commercial banks in the United States, which increased by 14 billion dollars from the end of 1945 to the end of October this year. The growth exceeded 3 billion dollars in the last four months and is continuing. This growth was on top of a nearly three-fold wartime expansion in deposits and currency which was greatly in excess of needs and has been an important basis of postwar inflationary pressures.

The basis of this continued expansion in bank deposits has been primarily the growth in bank loans, which has been at a more rapid rate than at any time in American banking history, amounting in the aggregate to 10 billion dollars since the end of 1945. Other factors in the deposit increase have been an addition of nearly 2 billion dollars to bank holdings of securities other than those of the Federal Government and gold acquisitions amounting to about 3 billions.

These increased loans have been made to businesses, to holders of real estate, and to consumers. Only loans on securities have declined. This decrease is due to liquidation of loans made to purchase Government securities in war loan drives, but loans on other securities have also failed to advance. This is an exceptional situation for a period of inflationary development and is in large part due to the Board's regulation of margin requirements.

It is true, as the Council points out, that banks have reduced their holdings of Government obligations as loans have increased. This decline, however, followed a temporary peak reached during the Victory Loan Drive and resulted almost wholly from Treasury use of its excessive balances at banks temporarily built up to a high level during the drive. It has not had any effect in reducing private deposits.

Inflationary impact of bank loan expansion

The Board agrees with the Federal Advisory Council that the basic causes of inflation lie primarily outside of the area of current monetary and banking developments. However, the Board believes that all possible measures and policies should be adopted by Government, business, farmers, and workers to produce more, consume less, and save more, and to avoid cost- and price-raising actions. Furthermore, the Board considers that the most effective means of diminishing the basic causes of inflation is maintenance of the largest possible surplus in the Government's budget. This important means of dealing with the problem is entirely ignored by the Council.

The Board also recognizes that individual banks in making loans are no doubt being guided by the aim of meeting the necessary and constructive needs of borrowers, and that many banks are aware of the dangers in the present situation and are exercising some restraint on borrowers. Expansion in lending has to a large extent been necessary to supply working capital needed by business to maintain or increase production at rising prices. As accumulated cash balances are drawn down funds must be borrowed. Consumers also borrow to supplement incomes and purchasers of homes borrow more than sellers repay because of advancing real estate prices.

In the Board's opinion it is not correct to contend that because inflation calls forth an increased demand for bank loans, these loans do not contribute to inflation. The economy now is caught in a partly self-generating spiral of rising wages, costs, prices, and profits supported by active use of previously accumulated liquid assets and by expanding bank loans. Credit is contributing to the continuation of inflationary pressures. As was well stated, in a recent Monthly Letter of the National City Bank of New York:

> "Rapidly accumulating debt is both a cause and a consequence of the inflationary pressures, for in a wage-price spiral, business constantly needs more and more money to keep going and this leads to the incurrence of more and more debt by business and more and more spending by the individual. To check this kind of spiralling--which is to the ultimate benefit of no one and to the injury of all--is not simple."

Although each loan, taken separately, may aid in the production and movement of goods, yet in view of the limited supplies of goods available, a loan to one business or individual to finance the purchase or holding of goods permits the borrower to bid against someone else who has or is able to obtain funds. Credit expansion thus is called for by price increases and provides the basis for further increases. This process, unless checked by positive limitations on the available supply of credit, could easily lead to catastrophic collapse.

Bankers, businessmen, farmers, wage earners, who in their operations unwittingly contribute to the rising spiral of inflation, cannot individually be held responsible for its course. That course is the result of reliance on the free-enterprise, competitive price system in a situation where demand, supply, and price are not in equilibrium and where a rise in prices can be prevented only through the maintenance of a harness of controls by Government.

For these conditions, the bankers are not responsible either individually or as a group. Their job is to meet the credit needs of their communities constructively, competitively, and profitably; they are not individually in a position to refuse the legitimate, sound credit demands of their customers. They find themselves in a situation in which they can readily meet unlimited credit demands from the public and in which the public's credit demands are vigorously sustained. That situation was created by war, by the necessities of war finance, and by premature abandonment of controls, thereby releasing inflationary pressures. Responsibility of the individual banker for developments can go no further than observance of prudent policy in the extension of credit and the maintenance of proper soundness of loans and liquidity and safety of individual banks.

Responsibility of Government for credit expansion

The Federal Advisory Council states that Government agencies have been making loans that banks refrained from making. Except in the field of foreign lending, the volume of loans by Government credit agencies is very small relative to the volume of bank loans and the total has not increased. It is true that some of the activities of Government agencies, furthering objectives set forth by Congress, have encouraged unhealthy credit expansion in the field of housing, primarily to aid veterans. Foreign lending by the Government has expanded because of the urgency of restoring production abroad and the difficulties and inadvisability of obtaining private credits for these essential purposes.

The Council refers to the Board's request for authority to guarantee loans in cases where credit is needed but cannot be obtained from banks. The Board wishes it clearly understood that it is requesting merely an amendment of an existing provision of law, for the purpose of rescinding a power which the Reserve Banks already have to make loans and revising somewhat their power to guarantee loans. Under existing conditions these powers are not likely to be used but some such power will be needed at times in the future to provide for small business a source of capital, which large corporations can obtain through sales of securities in the market. Amendment of existing law has been recommended to enable the System to return certain funds to the Treasury and this provides an appropriate opportunity to make other long-needed revisions. With reference to this bill the Federal Advisory Council expressed its views on November 18, 1947, as follows:

"The Council is cognizant of the investigation of the activities and powers of the Reconstruction Finance Corporation now being made by a Congressional Committee. Until Congress has determined whether the Reconstruction Finance Corporation should be continued, and, if continued, what powers to make or guarantee loans should be given it, the Council feels that no action by Congress should be taken on Senate Bill 408. The Council feels that Senate Bill 408 should be considered only as an alternative to legislation continuing the present loan and guarantee powers of the Reconstruction Finance Corporation. If the Congress should decide to continue the Reconstruction Finance Corporation without greatly curtailing its loan and guaranteeing powers, the Council would be opposed to the passage of Senate Bill 408. The majority of the Council would prefer Senate Bill 408 to the continuation of the Reconstruction Finance Corporation powers, but it should also be noted that a minority of the Council is against giving any guarantee or commitment powers to the Federal Reserve Banks under any circumstances, as proposed in Senate Bill 408."

Means of restricting inflation

The Board cannot agree with the Council's view that the Reserve System and the Treasury have ample powers to place all restraints on credit expansion that the System may consider necessary. As the Board has pointed out in its Annual Reports for 1945 and 1946 and in other statements, banks are in a position to provide any additional credit demanded by borrowers and the System cannot prevent such expansion. This is the case because commercial banks of the country now hold 70 billion dollars of United States Government securities, any part of which they can readily sell in order to obtain funds to make loans.

When banks sell Government securities, the Federal Reserve, which provides the ultimate market for Government securities, must purchase them in the absence of other buyers in order to prevent a breakdown of the securities market. Federal Reserve purchases create bank reserves which can be expanded by the banking system into more than six times as much in loans and investments.

The Council suggests that the System can restrain inflationary credit expansion through use of existing powers, including authority to increase the discount rate, to sell securities in the open market, and to raise reserve requirements at central reserve city banks. None of these powers can be used effectively if banks continue to sell Government securities to the Reserve System and thus create additional bank reserves.

In fact attempt to use these powers would increase sales of Government securities in the market by banks and others. If the System refused to purchase any more securities, bond prices would decline sharply. The threat of such a policy would induce a wave of selling of marketable bonds, and if prices on these bonds declined there might be widespread redemptions of savings bonds, which are redeemable on demand. The Reserve System would have to purchase securities in order to meet the drains on the Treasury, and new reserves would thereby be created.

Recent measures by the System and the Treasury to raise interest rates on short-term Government securities have diminished somewhat the inducement to banks to sell short-term securities and to purchase longer-term higher-rate issues. Higher rates on short-term securities, however, have but little, if any, influence in discouraging banks from selling them to make loans. Moreover, a recent increase in capital demands has put some pressures on the long-term securities market, and has resulted in a decline in bond prices. This places a limit on the extent to which short-term rates may be permitted to rise without causing an undue drop in Government bond prices.

The Board has proposed a means of curbing the ability of banks to create additional reserves by selling Government securities to the System and of reducing the amount of credit expansion that may be possible on the basis of reserves thus created or arising from a continued gold inflow. This proposal calls for granting to the System a temporary authority to require all banks to hold a special reserve in Treasury bills, certificates and notes or in certain cash assets, in addition to present basic required reserves.

This measure would enable the System to impose some restriction on undue credit expansion without depriving banks of earning assets. It would permit a rise in lending rates to new private borrowers without raising the interest cost on the outstanding debt of the Government, which is not now increasing. It would not prevent banks from meeting essential credit needs of the economy but would discourage unrestrained expansion of credit for any purpose.

Use of an instrument such as the one proposed would enable the System to curb credit expansion with much less burden on banks and less threat to Government credit than would result from attempt to use effectively any of the existing powers mentioned by the Federal Advisory Council.