MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 14, 1948

The fourth statutory meeting of the Federal Advisory Council for 1948 was convened in Room 932 of the Mayflower Hotel, Washington, D. C., on Sunday, November 14 ,1948, at 2:10 P.M., the President, Mr. Brown, in the Chair.

Present:

Charles E. Spencer, Jr.	District No. 1
W. Randolph Burgess	District No. 2
David E. Williams	District No. 3
John H. McCoy	District No. 4
Robert V. Fleming	District No. 5
J. T. Brown	District No. 6
Edward E. Brown	District No. 7
James H. Penick	District No. 8
Henry E. Atwood	District No. 9
J. E. Woods	District No. 11
Reno Odlin	District No. 12
Herbert V. Prochnow	Secretary

Absent:

James M. Kemper	District No. 10

President Brown stated that a director of the Federal Reserve Bank of Chicago had given him a resolution which it was anticipated the Board of Directors of that bank would be asked to consider. The director of the Federal Reserve Bank of Chicago requested that President Brown present the resolution to the Federal Advisory Council for its consideration. The resolution follows:

RESOLUTION

WHEREAS, the Board of Governors is committed to the policy of maintaining for the foreseeable future the 2½% interest rate on long-term United States Government bonds, and the Federal Reserve System's holdings of such bonds have increased from $427,540,000 on November 12, 1947, to over $9,171,000,000 on November 3, 1948, and may continue to increase at a very substantial rate, particularly in the event reserve requirements of member banks are further increased, and

WHEREAS, the book (or actual) loss on the Federal Reserve System's holdings of Government bonds may reach sizable proportions should the Board of Governors at some future time materially reduce or discontinue its present support level of the long term issues of Government bonds, and

WHEREAS, in times of financial stress the Federal Reserve Banks (in addition to discounting eligible paper) may be called upon to make a large volume of loans to member banks pursuant to Section 10 (b) of the Federal Reserve Act (enacted February 27, 1932), as amended, upon which extensive losses may be sustained, and

WHEREAS, there is a great disparity between the combined paid-in capital and surplus of the twelve Federal Reserve Banks and their combined deposit liability, it is the consensus of this Board, all of the circumstances considered, that it would be desirable at this time to increase the paid-in capital of the Reserve Banks by calling on member banks as soon as practicable for the remaining 50% of their respective capital subscriptions, thereby siphoning approximately $200,000,000 from the member banks into the System, which action would be deflationary in its effect and, therefore, desirable under present economic conditions; now, therefore be it

RESOLVED: That the Directors of the Federal Reserve Bank of Chicago recommend to the Board of Governors that they provide at the earliest possible date for an increase in the paid-in capital stock of the Federal Reserve Banks by calling upon all member banks for the payment of the remaining 50% of their respective capital stock subscriptions pursuant to Paragraph 3 of Section 2 of the Federal Reserve Act.

* * * *

The members of the Council decided that the resolution above might merit consideration at a later date, but that now was not an opportune time to urge action on it.

The following items on the agenda were then discussed:

1. THE QUESTION OF THE REORGANIZATION OF FEDERAL CREDIT AGENCIES IN VIEW OF THE ACTIVITIES OF THE HOOVER COMMITTEE.

2. A DISCUSSION OF FURTHER STEPS IN CONNECTION WITH RESERVE REQUIREMENTS, AS WELL AS THE QUESTION OF THE TIMING OF RATES ON SUBSEQUENT GOVERNMENT ISSUES.

It was agreed by the members of the Council and the Board that the discussion would be informal and without the preparation of written memorandums as had been the custom in recent meetings of the Council and the Board. During the course of the discussions, it was decided to prepare written memorandums, especially since Chairman McCabe requested a written copy of President Brown's summary of the Council's viewpoint on the staff report of the Hoover Committee. Consequently, there are printed in these minutes on pages 43 to 50, inclusive, three written memorandums which were prepared following the meeting of the Council and the Board on November 16, 1948, and sent to the Board of Governors. The first memorandum will be found on pages 43 and 44; the second on pages 45, 46, 47 and 48; and the third on pages 49 and 50.

The meeting adjourned at 6 P.M.

HERBERT V. PROCHNOW
Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 15, 1948

At 10:00 A.M., the Federal Advisory Council reconvened in Room 932 of the Mayflower Hotel, Washington, D. C.

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

The Council continued its discussions on the agenda which began at the meeting on November 14. The conclusions of the Council on these items of the agenda are to be found in memorandums printed in these minutes on pages 43 to 50, inclusive.

President Brown asked whether the Council had any changes to suggest in the Secretary's mimeographed notes for the meetings held on February 15-17, 1948, April 25-27, 1948, and September 19-21, 1948. There were no suggested changes.

The meeting adjourned at 12:15 P.M.

HERBERT V. PROCHNOW
Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

November 15, 1948

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

President Brown presented Dr. Frank A. Southard, Jr., Associate Director, Division of Research and Statistics of the Federal Reserve Board, who spoke on "Current Developments in International Finance."

The meeting adjourned at 3:30 P.M.

HERBERT V. PROCHNOW
Secretary.

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

November 16, 1948

At 10:30 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 Thomas B. McCabe; Governors Marriner S. Eccles, M. S. Szymczak, Ernest G. Draper, R. M. Evans, James K. Vardaman, Jr., and Lawrence Clayton; also Mr. S. R. Carpenter, Secretary of the Board of Governors.

Present: Members of the Federal Advisory Council:

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

The members of the Council and the Board then considered the following agenda item:

A DISCUSSION OF FURTHER STEPS IN CONNECTION WITH RESERVE REQUIREMENTS, AS WELL AS THE QUESTION OF THE TIMING OF RATES ON SUBSEQUENT GOVERNMENT ISSUES.

President Brown presented the views of the Council, which were later submitted to the Board in written form and are inserted in these minutes on pages 43 and 44.

Dr. Burgess presented figures showing expenditures for new durable goods, and stated that it was important to emphasize these expenditures when considering the problem of inflation, rather than to place constant emphasis on bank reserves and banks as the source of the inflation. A memorandum which Dr. Burgess prepared on this subject and which was later sent to the Board of Governors, following approval by the Executive Committee of the Federal Advisory Council, appears on pages 45, 46, 47 and 48.

Chairman McCabe stated that it was important to know something of the type of capital expenditures, as some capital expenditures are good and some are bad.

Mr. Eccles stated that the last increase in reserves merely sterilized the inflow of gold and the purchase of securities from insurance companies and others.

Mr. Odlin commented that the price mechanism performs an important function in our economy; inflation can not be stopped simply by increasing reserves.

The members of the Council and the Board discussed the question of the reorganization of Federal credit agencies in view of the activities of the Hoover Committee. President Brown then presented the conclusions of the Council, which were later submitted to the Board in written form and are inserted in these minutes on pages 49 and 50.

Chairman McCabe stated that the Board had not yet made a study of the *Staff Report on the Federal Reserve Board for the Committee on Independent Regulatory Commissions of the Hoover Commission*. There was some discussion of the operation of the dual banking system, as well as discussion regarding the advantages and disadvantages to small banks of membership in the Federal Reserve System.

Chairman McCabe and Mr. Eccles indicated that the Board and the Council were in agreement with the Council's statement regarding the independence of the individual Federal Reserve banks, as expressed in the *Memorandum* to be found on pages 49 and 50, of these minutes.

There was a very brief discussion regarding recommendations the Council might make to the Board relative to possible banking legislation. The Board of Governors did not indicate the nature of any banking legislation which it might present to the Congress for consideration.

The meeting adjourned at 3:10 P.M.

HERBERT V. PROCHNOW
Secretary

MINUTES OF THE MEETING OF THE EXECUTIVE COMMITTEE OF THE FEDERAL ADVISORY COUNCIL

November 16, 1948

At 3:17 P.M., the Executive Committee of the Council convened in the Conference Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Messrs. Charles E. Spencer, Jr., Robert V. Fleming, W. Randolph Burgess, David E. Williams, John H. McCoy, and Herbert V. Prochnow, Secretary.

The Committee discussed the subject matter of a statement that might be prepared and given to the Board relative to the Board's possible recommendations to the President regarding bank legislation. It was decided to send the Board the Memorandum which was later prepared and approved by the Executive Committee, and which appears on pages 43 and 44, in these minutes, together with the Memorandum prepared by Dr. Burgess, which was likewise approved by the Executive Committee, and which appears on pages 45, 46, 47 and 48 in these minutes. The Memorandum by Dr. Burgess was sent by him to Chairman McCabe on November 19, and the Memorandum which appears on pages 43 and 44 was sent by the Secretary of the Council to the Secretary of the Board of Governors on November 22, 1948.

On December 4, 1948, the Secretary of the Federal Advisory Council sent to the Secretary of the Board of Governors for the attention of the Board, the Memorandum which appears on pages 49 and 50 of these minutes relative to the *Staff Report on the Federal Reserve Board for the Committee on Independent Regulatory Commissions of the Hoover Commission.*

The meeting adjourned at 3:50 P.M.

HERBERT V. PROCHNOW
Secretary.

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL, NOVEMBER 22, 1948

The unforeseen outcome of the election has brought at least a temporary reluctance on the part of business concerns in some sections of the country to promote further capital expansion programs. This hesitation to proceed with business plans will probably continue until the Administration program relating to taxes, labor legislation, and other measures concerning business has been announced and the attitude of the new Congress can be appraised. The election has also affected the security markets. The government bond market has been stronger, partly because of the feeling that the Administration will maintain the present support policy for government securities, and partly because of the feeling that it is likely the volume of new corporate securities offered will be less because of the cancellation or postponement of expansion plans and that a government bond yielding 2½ per cent may be an attractive investment in comparison with the probable yield on the reduced supply of high grade corporates.

The members of the Council do not now find any clear and uniform economic trend evident throughout the twelve Federal Reserve districts. The Council, therefore, believes that until the trend following the election becomes much clearer, it would not be advisable "to rock the economic boat." Specifically, the Council believes it would not be desirable under present circumstances to change (1) the reserve requirements, (2) the rediscount rate, or (3) the support policy for government securities.

The Council further believes that increasing bank reserves is not the proper method of dealing with the problem of inflation. One of the results of an increase in bank reserves under current conditions is the transfer of government securities from banks to the Federal Reserve Systen, thereby largely nullifying any possible benefits from increasing the reserves and making the problem of debt management by the Treasury more difficult. An increase in member bank reserves not only makes membership in the System less desirable, but it also affects the earnings of some banks adversely. The overall earnings of banks may be satisfactory, but the arbitrary character of an increase in reserves in all banks affects the earnings of individual banks unfairly.

The repeated emphasis on bank deposits and on the banks as a major factor in causing inflation gives the public an erroneous impression of the principal reasons for the current inflation, which are to be found in the great expansion in the production of durable goods including housing and in large expenditures for defense, foreign aid and veterans' assistance. Attempts to control through monetary policy an inflation which has resulted from conditions largely outside the banking system are certain to be unsuccessful.

The Council appreciates that members of the Board have on some occasions called attention publicly to those factors outside the banking system which are principally responsible for the inflation. If these facts could be reemphasized whenever the occasion permits, it would be very helpful to a better public understanding of the situation.

With the conditions now prevailing, any proposals to increase reserves under the present authority, to request additional authority to impose still higher reserves, or to seek authority for special reserves for banks would in view of the foregoing comments be opposed by the Council, and by bankers generally, as detrimental to the best interests of the economy.

The Council believes it would be helpful if a comprehensive study could be made of the whole question of bank reserves, including such subjects as the purposes bank reserves serve, whether authority to vary reserves should be granted or whether they should be fixed definitely by legislation, and the proper relationship of reserves to the various classes of deposits, and to the size and location of banks. This study might be undertaken by a committee including representatives of the banking agencies of the Federal government, the banking departments of the state governments and the banks. An objective and exhaustive study in this field would be a useful guide to ultimate legislation.

In relation to the matter of interest rates on Government securities, the Council has at other times stated that under present conditions it would be beneficial to our economy to have a modest rise in short term rates. Even a small increase in these rates is helpful in reducing the demand for credit by making both borrowers and bankers aware of the dangers in the present situation. The timing of any increase in such rates should be a matter of agreement between the Board of Governors and the Treasury.

PRESENT CAUSES OF INFLATION IN EXPENDITURES FOR DURABLE GOODS

November 19, 1948

Whereas the increase in bank loans and investments, and in bank deposits appears now to be checked, this is not true of expenditures for durable goods, which show continued expansion. These are financed largely through the capital markets, through life insurance companies, or through business savings.

The figures are shown in the attached table and chart, which indicate that expenditures for new durable goods in 1948 are likely to total about $57 billion. This is more than twice as large as in the late '20's, and shows an increase of $8 billion over 1947.

It is in this area that the active factors in the recent inflation are to be found, rather than in bank credit, which is the short term operating fund necessary for current operations when the volume of the country's business is so large.

With some increase in armament expenditures likely to occur, the greatest danger of inflation lies in this area of durable goods. It is these huge expenditures which tend to run beyond our supply of labor and materials, and far beyond the amount of the nation's savings and lead to sales of securities to the Federal Reserve Banks. Expenditures of this sort have a doubly inflationary effect, because to a considerable extent production in this field involves the payment of wages and the purchase of materials, which creates purchasing power, but does not create the things that individuals may buy with the money.

A large part of these expenditures is good and necessary for the long term progress of the country. We need more houses, more utility capacity, more hospitals, new productive machinery, and new locomotives. The problem is one of timing. We have been trying to do too much too fast, and that has been largely responsible for rising prices.

If the present hesitation in business proves temporary, and the inflationary trend is resumed, we ought to turn our attention to these expenditures on durable goods as the active cause of inflation. It is there that something should be done to spread operations over a longer period and so reduce the inflationary pressure.

If the same critical examination and campaign of public education were undertaken in this field as the bankers have voluntarily undertaken in the field of bank credit, the inflationary forces could be dampened down. The problem is, therefore, to find methods of giving leadership and responsibility in this field comparable to what has been done in bank credit.

Expenditures for durable goods cover a wide range, from business plant and equipment, through railroad equipment, housing, automobiles, and public spending by the Federal government and by states and municipalities. To deal with such a diverse group of institutions and people calls for respected leadership.

It is suggested that a capital goods committee be appointed by the President, consisting of such government officials as the Secretary of the Treasury, the Chairman of the Federal Reserve Board, The Secretary of Commerce, the Chairman of the S.E.C., and the Chairman of the National Resources Board; and consisting also of public representatives, such as a banker, an insurance president, an industrialist, an agriculturist, and a labor leader.

It is suggested that this committee be asked to examine the country's plans and program of expenditures for durable goods, and make recommendations to the government, to business, and the general public as to what types of durable goods expenditures might wisely be postponed in order to avoid congestion of plants and markets, and practicable methods of achieving this goal. The recommendations of such a committee would carry great weight with insurance companies, business concerns, and the Federal and state governments.

This proposal would have the advantage of focusing public attention on the place where the inflationary danger is greatest.

EXPENDITURES FOR NEW AND DURABLE GOODS

Billions of Dollars

	Producers Plant & Equipment	Consumers *Housing*	*Durable Goods*	*Total*	*Institutional (Private)*	*Total Private*	*Total Public*	*Grand Total*
1919	7.1	1.8	5.5	7.3	.2	14.5	.9	15.5
1920	8.3	1.7	6.4	8.2	.2	16.7	1.2	17.9
1921	5.2	2.0	5.1	7.1	.3	12.6	1.5	14.1
1922	5.8	3.4	5.7	9.1	.4	15.3	1.7	16.9
1923	7.9	4.4	7.3	11.7	.4	20.0	1.6	21.6
1924	7.7	4.8	7.2	11.9	.5	20.0	1.9	21.9
1925	8.2	5.1	7.8	12.9	.6	21.7	2.1	23.8
1926	9.1	4.8	8.5	13.4	.7	23.2	2.1	25.3
1927	8.8	4.6	8.1	12.7	.7	22.2	2.4	24.6
1928	8.8	4.4	8.6	16.9	.7	22.5	2.5	24.9
1929	10.1	3.2	9.2	12.4	.6	23.1	2.4	25.5
1930	8.3	1.8	7.0	8.9	.5	17.7	2.8	20.4
1931	5.1	1.4	5.3	6.7	.4	12.2	2.6	14.8
1932	2.8	.5	3.3	3.9	.2	6.9	1.8	8.7
1933	2.4	.4	3.4	3.8	.1	6.3	1.3	7.6
1934	3.4	.4	4.4	4.8	.1	8.3	2.0	10.4
1935	4.3	.8	5.5	6.4	.1	10.8	1.8	12.6
1936	5.8	1.4	7.1	8.4	.2	14.4	3.3	17.7
1937	7.6	1.7	7.7	9.5	.2	17.2	2.8	20.0
1938	5.4	1.6	5.8	7.4	.2	13.1	3.4	16.4
1939	6.0	2.2	6.4	8.6	.2	14.8	3.4	18.3
1940	7.4	2.5	7.4	9.9	.2	17.5	3.6	21.1
1941	9.4	2.9	9.1	12.0	.2	21.6	6.7	28.3
1942	7.0	1.4	6.3	7.7	.1	14.8	13.8	28.6
1943	5.3	.8	6.6	7.3	—	12.6	9.2	21.8
1944	6.4	.6	6.2	6.8	.1	13.2	3.6	16.8
1945	8.0	.8	7.7	8.5	.1	16.6	3.1	19.7
1946	14,0	3.4	16.2	19.6	.4	34.0	2.2	36.2
1947	19.1	5.5	21.0	26.5	.5	46.0	3.1	49.1
1948	22.0	7.4	23.0	30.4	.8	53.1	4.2	57.3

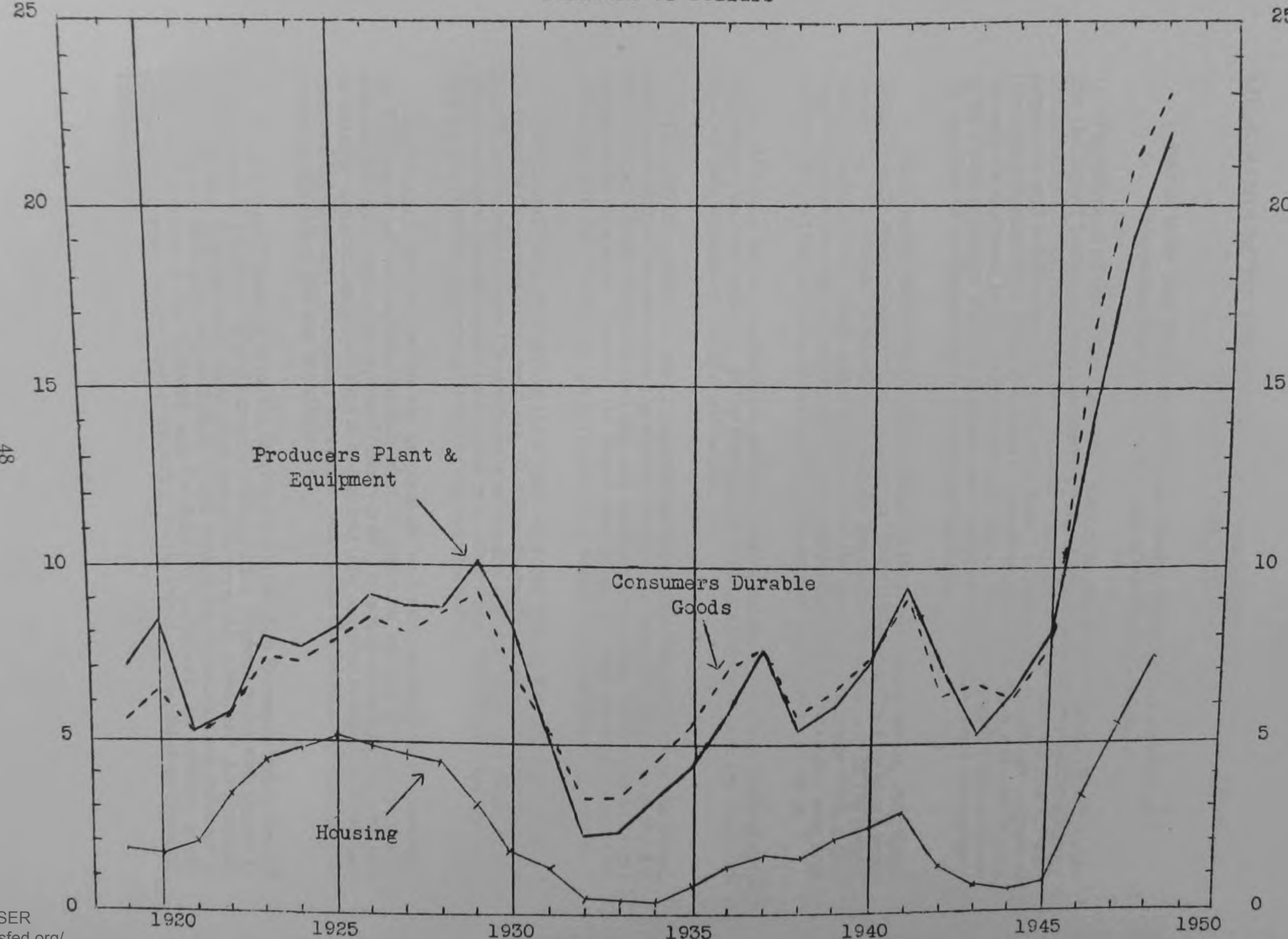
Sources: 1919-1938—Federal Reserve Bulletin, Sept. 1939, "Estimated Expenditures for New Durable Goods 1919-1938", George Terborgh.

1939-1945—Federal Reserve Bulletin, Sept. 1946, "Estimated Durable Goods Expenditures, 1939-45", Doris P. Warner and Albert R. Koch.

1946-1948—Confidential Federal Reserve Report, October 6, 1948, "Estimated Durable Goods Expenditures 1946-1948", Albert R. Koch.

November 12, 1948

Expenditures for Durable Goods
Billions of Dollars



MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL

Relative to the Staff Report on the Federal Reserve Board for the Committee on Independent Regulatory Commissions of the Hoover Commission

The foreword of the preliminary Staff Report on the Federal Reserve Board states that the Report has not yet been considered by the Committee on Independent Regulatory Commissions. It further states that "it reflects only the views of the staff member who prepared it and is still subject to revision by him." Consequently, no attempt is made in this memorandum of the Federal Advisory Council to analyze in detail and exhaustively the subjects discussed in the preliminary Staff Report. The Council wishes to state some of the broad principles which it believes merit serious consideration in any discussion of the functions of the Federal banking and credit agencies.

1. The Council believes in the maintenance of the dual banking system. No change should be made which would weaken this system. Even if it were desirable to have a single unified banking system, it would be politically impossible to establish it at the present time. Experience over many years indicates that the checks and balances which a dual banking system provides, as well as the healthy competition which it promotes, have been constructive and helpful in the growth and development of the American economy.

2. Although historical experience indicates that a nation cannot have a completely independent central bank, it is highly desirable that the central bank have the maximum practical independence of thought and action.

The difficult problem is one of maintaining reasonable independence of the Board, while providing at the same time the desired co-operation with the objectives of the Administration. The Board should obviously not be subservient to the Treasury and to every change in its viewpoint. However, the Board must necessarily find practical means of co-operating with the Treasury in the development of sound fiscal and monetary policies.

The Council does not approve the suggestion in the Report for reducing the size of the Board of Governors to five members. It would lessen the prestige and influence of the Board, and it might create the uncertainty of possible changes in the size of the Board whenever a new Administration took power or at other times. The Board is not too large now for the effective discharge of its important responsibilities.

The Council does not believe the proposal for an Under Secretary of the Treasury for Banking would be practical. In discussions of important matters of monetary policy, when he would be expected to express Treasury policy, he would undoubtedly be reluctant to state his viewpoint until such time as he had had time to confer at length with the Secretary of the Treasury. Experience in previous years when the Secretary of the Treasury served on the Board also was not satisfactory.

3. The Council does not favor the creation by statute of an Economic Policy Council which would be set up to facilitate making and executing "Federal policy with respect to credit, finance, lending, bank supervision and other economic activities." An Economic Policy Council with these responsibilities would weaken the importance and influence of both the Secretary of the Treasury and the Board of Governors. In addition, ample authority now exists, without further legislation, for the President to establish an Economic Policy Council.

4. The Council favors substantially higher salaries for the members of the Board of Governors so that the remuneration may bear some relationship to the responsibilities of the Board, and so that men of the highest competence may find it possible to serve in this capacity.

5. The Council believes the maintenance of the independence of the individual Federal Reserve banks is of special importance. The directors of the individual Federal Reserve banks should continue to have the authority to elect the presidents of their respective banks, and the presidents of the Federal Reserve banks should continue their present participation in the activities of the Open Market Committee. Adequate salaries and reasonable independence in the management of the individual Federal Reserve banks offer the greatest assurance that men of ability will find executive positions in these banks attractive.

6. The Council is opposed to any program which would place the functions of bank supervision and examination under the control of the banking agency which has the responsibility for monetary policy. The Council does not believe it is sound to combine bank examination and supervision with the objectives of fiscal and monetary policy. Bank examinations should be objective and should not be used to carry out fiscal and monetary policies.

Because of the particular responsibilities which they discharge daily, bankers are in the best position to determine the practical wisdom of fiscal and monetary policies. They may, on occasion, feel impelled to criticize such policies, and they will be reluctant to do so if bank examinations and supervision are under the control of the banking agency making policies. Bankers who are critical may fear retaliation in bank examinations. To restrict in any way the freedom to speak freely would be unfortunate both for the banking system and the American economy.

December 3, 1948.

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

H. V. P.

The Secretary's notes on the meeting of the Federal Advisory Council on November 14, 1948, at 2:10 P.M. in Room 932 of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present, except Mr. Kemper who was unavoidably detained until late in the afternoon because of transportation delays.

THE QUESTION OF THE REORGANIZATION OF FEDERAL CREDIT AGENCIES IN VIEW OF THE ACTIVITIES OF THE HOOVER COMMITTEE.

E. E. Brown states that a day or two after Burgess had submitted this item, Chairman McCabe telephoned Brown and suggested that the discussion of this item and the proposal for a National Monetary Commission should be informal and without written statements on the part of the Council or the Board. Brown reports that all members of the Executive Committee agreed to this procedure and he informed McCabe who also obtained the agreement of the members of the Board. Before discussing the above item, Brown reports that a director of the Federal Reserve bank of Chicago had given him a resolution which it is expected the Board of Directors of that bank would be asked to consider this week. The director requested that Brown present the resolution to the Council for its consideration. The resolution follows:

R E S O L U T I O N

WHEREAS, the Board of Governors is committed to the policy of maintaining for the foreseeable future the 2 1/2% interest rate on long term United States Government bonds, and the Federal Reserve System's holdings of such bonds have increased from $427,540,000 on November 12, 1947, to over $9,171,000,000 on November 3, 1948, and may continue to increase at a very substantial rate, particularly in the event reserve requirements of member banks are further increased, and

WHEREAS, the book (or actual) loss on the Federal Reserve System's holdings of Government bonds may reach sizable proportions should the Board of Governors at some future time materially reduce or discontinue its present support level of the long term issues of Government bonds, and

WHEREAS, in times of financial stress the Federal Reserve Banks (in addition to discounting eligible paper) may be called upon to make a large volume of loans to member banks pursuant to Section 10 (b) of the Federal Reserve Act (enacted February 27, 1932), as amended, upon which extensive losses may be sustained, and

WHEREAS, there is a great disparity between the combined paid-in capital and surplus of the twelve Federal Reserve Banks and their combined deposit liability, it is the consensus of this Board, all of the circumstances considered, that it would be desirable at this time to increase the paid-in capital of the Reserve Banks by calling on member banks as soon as practicable for the remaining 50% of their respective capital subscriptions, thereby siphoning approximately $200,000,000 from the member banks into the System, which action would be deflationary in its effect and, therefore, desirable under present economic conditions; now, therefore be it

RESOLVED: That the Directors of the Federal Reserve Bank of Chicago recommend to the Board of Governors that they provide at the earliest possible date for an increase in the paid-in capital stock of the Federal Reserve Banks by calling upon all member banks for the payment of the remaining 50% of their respective capital stock subscriptions pursuant to Paragraph 3 of Section 2 of the Federal Reserve Act.

* * * * * * * * * * *

E. E. Brown asks the Council for its opinion regarding the resolution. The members of the Council believe that the proposal in the resolution may merit consideration at a later date, but this is not an opportune time to urge action on it. The banks might be charged with trying to obtain increased earnings by this means. Brown then states, in connection with the first item on the agenda, that the last Congress had appointed a Commission to make recommendations for streamlining the operations of the government and increasing its efficiency. Various task groups were formed to make the preliminary studies. George L. Bach has made a preliminary study of the Federal banking and credit agencies. Brown reports that Bach's study has some bias but is fairly well done. Bach traces the historical development of the Federal Reserve System, including the difficult problem of giving the Board of Governors maximum independence, while having the Board responsive at the same time to the objectives of the Administration, particularly the Treasury. The report says that making the Board of Governors a part of the Treasury is not desirable because the Treasury thinks in terms of raising money, and those measures which will help it specifically. If the Board should disagree with the Treasury, it would be difficult for the Board to be effective. A major question is how can greater coordination be brought about so that the Board can retain independence and still cooperate with the objectives of the Treasury. Brown states that the Bach report suggests reducing the Board from seven to five members, four of whom would be appointed for eight years each, which would mean one member going out of office every two years. The fifth member of the Board would be an Assistant Secretary of the Treasury for Banking. Provision is made for giving the President power to remove the Chairman of the Board. The report also sets up an Economic Council, but it would have no power to issue directives.

Fleming understands that the person who prepared this report spent about twenty minutes each with the head of the FDIC and the Comptroller.

E. E. Brown. The report says that logically the government should own the stock of the Federal Reserve banks but that this is not too important. The report suggests electing Federal Reserve bank directors as they are now chosen. The report also suggests that the presidents of the Federal Reserve banks should be appointed by the Board of Governors and confirmed by the directors of the Federal Reserve banks. Brown states that he dislikes this latter suggestion as there have been instances in the past when attempts have been made to appoint presidents of Federal Reserve banks for political reasons when it would help to straighten out difficult situations which had arisen in Washington. The report also suggests that with a Board of five members, no presidents of the Federal Reserve banks should be on the Open Market Committee. The report also discusses bank supervision under the Comptroller, the FDIC and the Federal Reserve System. It states that logically there should be only one system of bank supervision but that this is not possible now. The report adds that whereas there is some waste now because of the present system of examination, the waste is not too serious. The report also expresses the belief that bank examination and supervision should be interrelated with monetary policy. Brown believes that the officers of banks would be the persons most likely to criticise Federal Reserve policy, and they would hesitate to be critical of policy if the supervision and examination of their banks were related to monetary policies.

Fleming. Edgar E. Mountjoy telephoned him and said that the Executive Committee of the National Bank Division of the American Bankers Association was drafting a statement protesting any weakening of the functions and position of the Office of the Comptroller of the Currency.

Burgess states that Haynes felt that the Comptroller's Office should not be under the Treasury where it may be used for political purposes. Haynes may have thought of the Federal Reserve Board as the place to put the functions of the Comptroller's office, but Burgess thinks that those who discussed the matter with Haynes have convinced him of the undesirability of the move he may have had in mind. The language describing the responsibilities of the Comptroller's office could indicate clearly that supervision was separate from the functions of the Secretary of the Treasury as it has always been up to recent years.

Fleming. The Comptroller's office is pleased with the National Bank Division letter, but thinks the language could be strengthened. Fleming believes McCabe is not particularly anxious to have the supervisory powers, whereas Eccles wishes to have them.

E. E Brown asks whether the results of the election have made any change in the suggestion for a National Monetary Commission. He is under the impression that the idea was suggested on the basis of the anticipated election of Governor Dewey. Brown is inclined to believe that it would be unwise to advance the idea of a National Monetary Commission at the present time.

Burgess states that he talked with Mr. Mitchell who believes that very little should be done or proposed now. If we look at the banking situation objectively, and assume we could get Congress to do anything we wish, there is actually very little that needs to be done urgently, particularly when one considers the risk attached to introducing any legislation.

Fleming believes Snyder is opposed to many of the conclusions in the Bach study.

E. E. Brown asks the opinion of the Council regarding the idea of a National Monetary Commission, and all members of the Council agree that it is not desirable now to suggest it.

Burgess thinks that one of our principal jobs as bankers is to remove the emphasis now given to monetary policy as the cause of our problems.

Atwood reports that John S. Graham, Assistant Secretary of the Treasury, told him he was surprised that no insurance executive had answered Parkinson.

E. E. Brown believes that the Council might express its opinion on some of the general aspects of the Bach report.

Fleming asks whether in substance the report does not aim at doing away with the dual banking system and centralizing authority.

E. E. Brown is opposed to centralizing supervision in a Board that has policy-making functions. The bankers are going to be the main policy critics, and it would be clearly undesirable to place them in a position where they would hesitate to criticise policies because of a possible retaliation in the examination of their banks.

Odlin thinks this report is a definite step to nationalize banks.

E. E Brown. There is also the question of giving the Board power to select the presidents of the Federal Reserve banks.

Fleming. A president of a Federal Reserve bank who had been selected by the Board of Governors would hardly dare to oppose the special reserve plan as Sproul did. Incidentally, Senator Glass felt that Secretary Mellon was too dominant on the Federal Reserve Board.

Burgess believes that to have the Secretary of the Treasury on the Board of Governors weakens the Board. He states also that having a top coordinator weakens the position of the Secretary of the Treasury.

Fleming favors a salary of $25,000 for the members of the Board.

J. T. Brown asks whether the salary provision is a part of the Federal Reserve Act.

E. E. Brown states that the matter of increasing the salaries of Board members could be included with suggested increases in other government salaries, and it might not be necessary to rewrite the Federal Reserve Act.

Burgess believes it is not desirable to dignify this preliminary report by a detailed discussion of it. It would be better to discuss it in its broader aspects and philosophy.

E. E. Brown states that Eccles wishes the reserves raised and Snyder does not.

Fleming believes the Board has negatived any gain it may have anticipated from raising reserve requirements.

E. E. Brown. The question of the independence of the Board and the necessity for going along with the Administration is one of the real problems.

Burgess. In country after country, the central banking authorities in the last analysis have had to go along with the Administration. A government is wise which keeps the central banking authority independent so the central banking authority can take the criticism when the brakes have to be put on an inflation. Burgess questions whether the person who wrote this preliminary report ever heard of this principle of central banking.

E. E. Brown states that he is strongly in favor of maintaining the dual banking system. Basically, any overhauling of the banking system should aim at preserving the dual system.

Odlin thinks the Council should comment on the report in terms of broad principles.

E. E. Brown summarizes some of the broad principles upon which the Council agrees:

(1) On the whole the Council believes that the dual banking system should be maintained. It should not be weakened. Checks and balances which a dual banking system provides have been constructive;

(2) The Council realizes the problem of maintaining the independence of the Board at the same time the Board works with the Administration. Some independence of thought and action by the Board is desirable. The Board should not be subservient to every wish and viewpoint of the Treasury, but it will also find many practical ways of cooperating with the Administration;

(3) The Council does not favor an Economic Council. This Council would weaken the position both of the Board of Governors and the Secretary of the Treasury. Moreover, the President has ample authority to appoint a Council without additional legislation;

(4) The Council favors substantially higher salaries for the members of the Board of Governors;

(5) The Council believes that the independence of the individual Federal Reserve banks is of prime importance, including such matters, for example, as the election of the president of a Federal Reserve bank by its directors and the participation by the presidents of the Federal Reserve banks in the activities of the Open Market Committee;

(6) The Council opposes combining the functions of bank supervision and examination with the objectives of fiscal and monetary policy. Bank examinations should be objective and should not be used to carry out fiscal and monetary policies. Bankers may on occasion wish to criticise Federal Reserve policies, and they will be reluctant to do so if bank supervision is interrelated with fiscal and monetary policy. They will hesitate to criticise policies because of possible retaliation in bank examinations. Freedom of speech would be restricted to the detriment of the banking system.

Penick states that he came to the meeting with the impression that the Hoover report was a dead cock in the pit. He doubts whether the Democrats would accept it.

E. E. Brown thinks they might take those parts of the report they felt they could use.

* * *

A DISCUSSION OF FURTHER STEPS IN CONNECTION WITH RESERVE REQUIREMENTS, AS WELL AS THE QUESTION OF THE TIMING OF RATES ON SUBSEQUENT GOVERNMENT ISSUES.

E. E. Brown. It is within the power of the Board of Governors to increase reserves, but the fixing of interest rates is within the power of the Treasury, except as it involves the activities of the Open Market Committee. Brown then comments off-the-record on some of the developments in business since the election, indicating cancellations of capital expansion programs and a reluctance to proceed with such plans until the Administration program on excess profits taxes, labor legislation and other matters is announced.

Fleming thinks the Council should ask whether the Board proposes to advance the special reserve plan or what the Board may have in mind. He believes they are planning some move.

Atwood asks how one can account for present bond prices.

Burgess. One reason for the present bond prices is the belief that the Administration is determined to hold prices, and people accept the ability and willingness of the Administration to support government security prices. In addition, as E. E. Brown has suggested, there are cancellations of some capital projects. If the Administration should proceed with an excess profits tax, and other proposals which would cause more hesitation in business, there might be a recession.

E. E. Brown thinks the people believe this Administration will hold bond prices.

Spencer. If the Administration enacts an excess profits tax, he believes that industries would not be inclined to expand. Some utilities, however, may continue to expand.

Burgess. The trend is not clear. Some business concerns are cancelling their expansion programs while others are going ahead. If there is to be further inflation, it will be in durable goods.

Williams. Consumer credit has declined. Some smaller industrial concerns are beginning to slow down and larger concerns are inclined to wait regarding plant expansion.

Fleming. Real estate activities are down, but the utilities are continuing to expand.

J. T. Brown states that there are no large manufacturing concerns in his district. Real estate and housing are showing a rather marked decline. The tendency is to stop, look and listen.

McCoy comments that business in his district is going along well. A few companies may be slowing up but the utilities and oil companies are still expanding. Consumer credit is off, and the second-hand car market is definitely off.

Atwood says that the trend is mixed although he has not heard of any major cancellations of expansion programs. He thinks it is too early to trace any definite economic trend. His district has never been as prosperous as it has been in the last few years.

Penick reports there has been no real slowing up of business activity in his district. Retail business activity is high, and the cotton and rice crops have been good.

J. T. Brown states that in his section the merchants have heavy inventories.

Woods reports business in his district is good, especially in Texas. A very profitable crop is being marketed. He has heard of no major cancellations of construction. Small construction is still going ahead. Some farmers are inclined to increase their acreage. Oil production has exceeded the all-time high.

Odlin. The situation in his district is complicated by the shipping strike. There have been substantial expenditures for power. Oregon and Washington voted for large pensions and bonuses. A great deal of school construction is going on. The used car market is down. Odlin has not noted any serious overstocking in inventories. He has been told that there is no real lumber market and that the honeymoon in lumber may be over, although the plywood market is still good. Odlin cannot say that the deflation has come, but he feels that every day we are a day nearer it. The apple market is not good.

E. E. Brown states that he has talked with a representative of a large paper company who says that the market for fine paper is not good.

Burgess. From the comments which have just been made it is obvious that the picture is not clear. From the standpoint of the Board it would be logical not to make any deflationary move at present. If there is any inflation, it is not in bank credit but in durable goods. Burgess then presents members of the Council with copies of the two pages which follow indicating the expenditures for new durable goods.

November 19, 1948

Present Causes of Inflation in
Expenditures for Durable Goods

Whereas the increase in bank loans and investments, and in bank deposits appears now to be checked, this is not true of expenditures for durable goods, which show continued expansion. These are financed largely through the capital markets, through life insurance companies, or through business savings.

The figures are shown in the attached table and chart, which indicate that expenditures for new durable goods in 1948 are likely to total about $57 billion. This is more than twice as large as in the late '20's, and shows an increase of $8 billion over 1947.

It is in this area that the active factors in the recent inflation are to be found, rather than in bank credit, which is the short term operating fund necessary for current operations when the volume of the country's business is so large.

With some increase in armament expenditures likely to occur, the greatest danger of inflation lies in this area of durable goods. It is these huge expenditures which tend to run beyond our supply of labor and materials, and far beyond the amount of the nation's savings and lead to sales of securities to the Federal Reserve Banks. Expenditures of this sort have a doubly inflationary effect, because to a considerable extent production in this field involves the payment of wages and the purchase of materials, which creates purchasing power, but does not create the things that individuals may buy with the money.

A large part of these expenditures is good and necessary for the long term progress of the country. We need more houses, more utility capacity, more hospitals, new productive machinery, and new locomotives. The problem is one of timing. We have been trying to do too much too fast, and that has been largely responsible for rising prices.

If the present hesitation in business proves temporary, and the inflationary trend is resumed, we ought to turn our attention to these expenditures on durable goods as the active cause of inflation. It is there that something should be done to spread operations over a longer period and so reduce the inflationary pressure.

If the same critical examination and campaign of public education were undertaken in this field as the bankers have voluntarily undertaken in the field of bank credit, the inflationary forces could be dampened down. The problem is, therefore, to find methods of giving leadership and responsibility in this field comparable to what has been done in bank credit.

Expenditures for durable goods cover a wide range, from business plant and equipment, through railroad equipment, housing, automobiles, and public spending by the Federal government and by states and municipalities. To deal with such a diverse group of institutions and people calls for respected leadership.

It is suggested that a capital goods committee be appointed by the President, consisting of such government officials as the Secretary of the Treasury, the Chairman of the Federal Reserve Board, The Secretary of Commerce, the Chairman of the S.E.C., and the Chairman of the National Resources Board; and consisting also of public representatives, such as a banker, an insurance president, an industrialist, an agriculturalist, and a labor leader.

It is suggested that this committee be asked to examine the country's plans and program of expenditures for durable goods, and make recommendations to the government, to business, and the general public as to what types of durable goods expenditures might wisely be postponed in order to avoid congestion of plants and markets, and practicable methods of achieving this goal. The recommendations of such a committee would carry great weight with insurance companies, business concerns, and the Federal and state governments.

This proposal would have the advantage of focusing public attention on the place where the inflationary danger is greatest.

Expenditures for New Durable Goods
Billions of Dollars

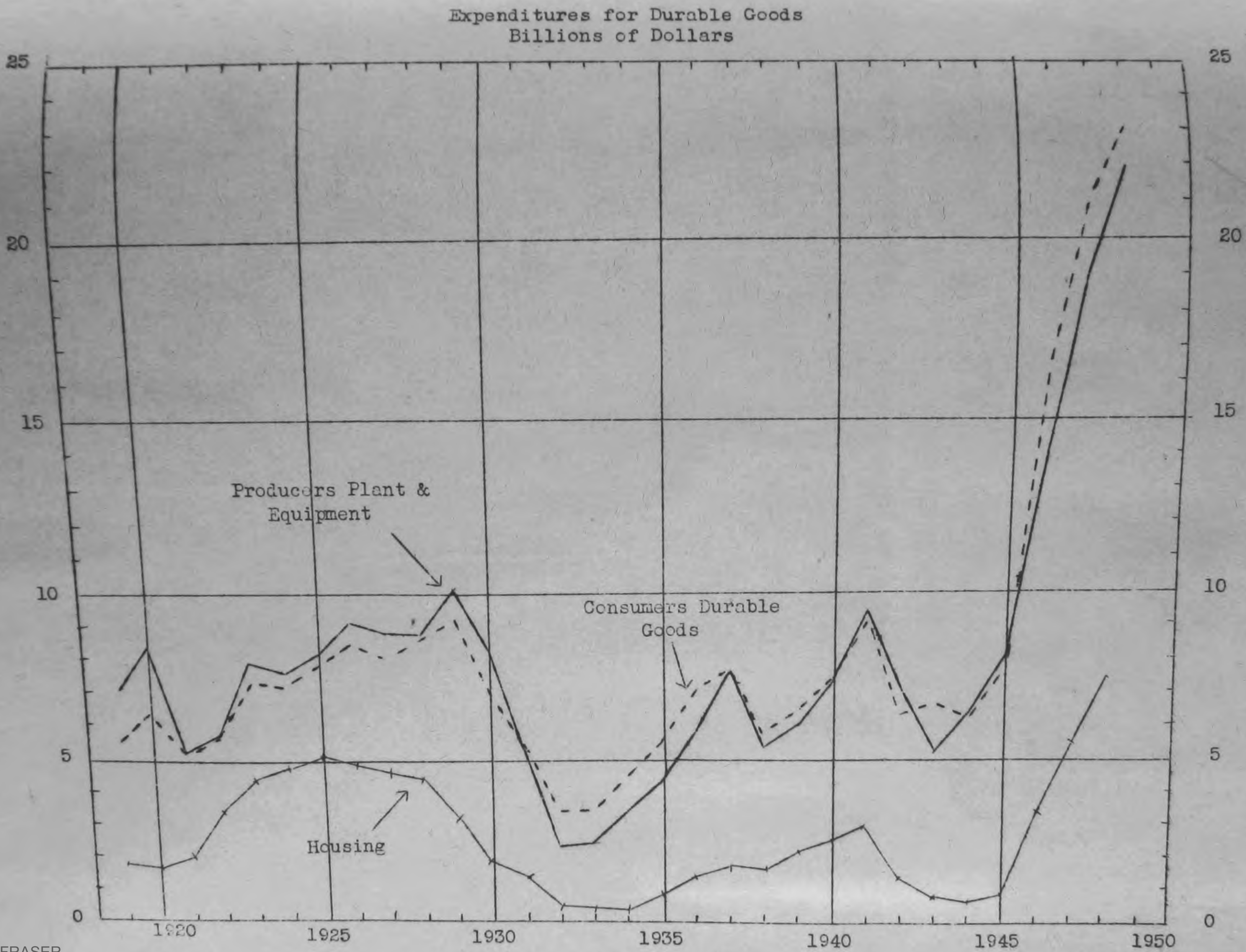
	Producers Plant & Equipment	Consumers			Institutional (Private)	Total Private	Total Public	Grand Total
		Housing	Durable Goods	Total				
1919	7.1	1.8	5.5	7.3	.2	14.5	.9	15.5
1920	8.3	1.7	6.4	8.2	.2	16.7	1.2	17.9
1921	5.2	2.0	5.1	7.1	.3	12.6	1.5	14.1
1922	5.8	3.4	5.7	9.1	.4	15.3	1.7	16.9
1923	7.9	4.4	7.3	11.7	.4	20.0	1.6	21.6
1924	7.7	4.8	7.2	11.9	.5	20.0	1.9	21.9
1925	8.2	5.1	7.8	12.9	.6	21.7	2.1	23.8
1926	9.1	4.8	8.5	13.4	.7	23.2	2.1	25.3
1927	8.8	4.6	8.1	12.7	.7	22.2	2.4	24.6
1928	8.8	4.4	8.6	16.9	.7	22.5	2.5	24.9
1929	10.1	3.2	9.2	12.4	.6	23.1	2.4	25.5
1930	8.3	1.8	7.0	8.9	.5	17.7	2.8	20.4
1931	5.1	1.4	5.3	6.7	.4	12.2	2.6	14.8
1932	2.8	.5	3.3	3.9	.2	6.9	1.8	8.7
1933	2.4	.4	3.4	3.8	.1	6.3	1.3	7.6
1934	3.4	.4	4.4	4.8	.1	8.3	2.0	10.4
1935	4.3	.8	5.5	6.4	.1	10.8	1.8	12.6
1936	5.8	1.4	7.1	8.4	.2	14.4	3.3	17.7
1937	7.6	1.7	7.7	9.5	.2	17.2	2.8	20.0
1938	5.4	1.6	5.8	7.4	.2	13.1	3.4	16.4
1939	6.0	2.2	6.4	8.6	.2	14.8	3.4	18.3
1940	7.4	2.5	7.4	9.9	.2	17.5	3.6	21.1
1941	9.4	2.9	9.1	12.0	.2	21.6	6.7	28.3
1942	7.0	1.4	6.3	7.7	.1	14.8	13.8	28.6
1943	5.3	.8	6.6	7.3	-	12.6	9.2	21.8
1944	6.4	.6	6.2	6.8	.1	13.2	3.6	16.8
1945	8.0	.8	7.7	8.5	.1	16.6	3.1	19.7
1946	14.0	3.4	16.2	19.6	.4	34.0	2.2	36.2
1947	19.1	5.5	21.0	26.5	.5	46.0	3.1	49.1
1948	22.0	7.4	23.0	30.4	.8	53.1	4.2	57.3

Sources: 1919 - 1938 - Federal Reserve Bulletin, Sept. 1939, "Estimated Expenditures for New Durable Goods 1919-1938", George Terborgh.

1939 - 1945 - Federal Reserve Bulletin, Sept. 1946, "Estimated Durable Goods Expenditures, 1939-45", Doris P. Warner and Albert R. Koch.

1946 - 1948 - Confidential Federal Reserve Report, October 6, 1948, "Estimated Durable Goods Expenditures 1946-48", Albert R. Koch.

November 12, 1948



Expenditures for Durable Goods
Billions of Dollars
25
20
15
10
5
0
1920
1925
1930
1935
1940
1945
1950
Producers Plant &
Equipment
Consumers Durable
Goods
Housing

Odlin believes it is time to ask the Board to leave the bank reserve position alone, as banks are controlling their credits satisfactorily.

Burgess believes that the Board will ask for more power. By its arbitrary action on reserves the Board has reduced the earnings of some banks. The ratio of earnings of banks to capital is much less than the comparable ratio of earnings of business to capital.

E. E. Brown thinks that there may be some differences of opinion on the question of earnings, in view of the prices at which stocks of corporations are selling.

Odlin says that the banks are entitled to be free from the "heckling" at least for a time.

Fleming does not believe the banks can increase their interest rates at present.

Spencer believes the two per cent rate is soft.

Fleming states that McCabe was influenced by a statement of Kurtz that the increase in interest rates will offset the losses banks have experienced because of the higher reserve requirements.

Burgess. The holdings of the Federal Reserve System have increased when they should have decreased. If the demand for capital exceeds the supply,then the price should go up.

F.D.I.C. ASSESSMENT.

Burgess states that the banks were promised relief when the fund reached one billion dollars.

E. E. Brown believes it would be desirable to raise any question of relief on the FDIC assessment through some channel other than the Board of Governors.

Spencer thinks it would be a mistake to take it up with the Board.

E. E. Brown. After various members of the Council agree with Spencer's viewpoint, Brown states that it is apparently the sentiment of the Council that it would not be advisable to take up this matter with the Board of Governors.

The meeting adjourned at 6 P.M.

The Council convened at 10:00 A.M. on November 15, 1948, in Room 932 of the Mayflower Hotel, Washington, D. C.

All members of the Council were present.

E. E. Brown suggests that the Council continue with its discussion of the second item on the agenda which was not completed yesterday. The item reads as follows:

"A discussion of further steps in connection with reserve requirements, as well as the question of the timing of rates on subsequent government issues."

Burgess believes that it is the responsibility of the Council to report to the Board the unfavorable sentiment of bankers generally regarding the recent increase in reserves. He thinks the emphasis on bank reserves has been overdone. The increase in reserves did not do any real good; it merely transferred securities to the Federal Reserve System. Burgess does not believe the Board should move further in this direction. The increase in reserves actually did damage to a number of banks. It may be true that the over-all position of banks was not injured, but individual banks were affected adversely. The increase in bank reserves and all the discussion about it have given the people the impression that the inflation is due to the banks. If there is an inflation, it is in the field of durable goods. The Board cannot avoid the responsibility of dealing with this situation. The pegging of government bonds is making the inflation possible. The Board cannot say that the expansion in durable goods is outside its responsibility, as the Board makes this expansion possible by pegging bond prices. When there is a demand in excess of the supply, prices normally rise; this same principle should apply to interest rates. The Board might also use its influence with cities, states and municipalities by urging them to postpone construction at the present time. The Board should also suggest to insurance companies that they use only their savings and not the proceeds from their sales of government securities.

Williams asks how this question will be dealt with in the discussion with the Board.

E. E. Brown replies that McCabe suggested the discussion should be informal and that written statements should not be prepared. Brown states he is not in complete accord with the statement by Burgess. He is not certain that the Board's action may not have restrained banks somewhat in their lending activities. It may have kept some banks from making special or marginal types of loans. Sooner or later, we shall have a recession - possibly a sharp one - and if the

Board can then decrease reserve requirements considerably, it may be helpful. Brown also states that he does not agree with Leffingwell that reserves should be fixed by law, with the Board given no power to change reserves.

Burgess states that he is inclined to agree with Leffingwell.

E. E. Brown asks whether Burgess has changed his views so that he now favors removing the peg or whether he believes as he formerly did in a slight drop in the peg.

Burgess states that his views have not changed. He would favor dropping the peg to around 98 or 99.

J. T. Brown asks whether the recent election upset will tend to curb the expansion in durable goods.

Burgess replies that no one knows whether or not the present situation is temporary.

Odlin believes that the emphasis by the Board of Governors on bank reserves is like treating the right arm for a disease of the whole body. The Board itself is engaged in the expansion of durable goods by constructing new branch buildings.

Fleming. The Council approved building branches.

Burgess. However, the Council did not approve construction of the buildings now.

Fleming reports that Woodlief Thomas told him that the insurance company sales of securities practically ceased after the election.

E. E. Brown thinks we may be in for a recession which will stop the expansion in capital goods. If fear develops, the recession may go a long way. Brown asks whether the Council has changed its viewpoint on pegging and finds there is apparently no change in the viewpoint of the members of the Council as previously expressed.

Burgess believes the Board will ask Congress for more authority over bank reserves, and he thinks the Council should meet this issue. He states that if you were in the driver's seat, you probably would not do anything right now. Burgess is inclined to believe that the power to change reserves should be in the hands of Congress; if it is placed in the Board's hands, it should be used only on extreme occasions. It gives the Board power to change the rules at any time.

E. E. Brown states that the Council is obviously in agreement that until the situation becomes much clearer, the Board should not disturb the reserve requirements or the support prices on government bonds. The Council also finds that banks generally disliked the recent increase in reserve requirements and that this increase injured individual banks. The Council is also opposed to any further grant of power by Congress for an increase in reserve requirements.

Burgess asks whether the Council should not also add that the constant emphasis on bank reserves has given the people a picture that is out of focus, and one that has failed to place the emphasis on other aspects of the economic situation, such as the expansion in durable goods where it belongs.

E. E. Brown says that the Council could add that it believes the extension of bank credit, other than that encouraged by the government, for example, in housing, has played a very small part in inflation. It is up to the Board to call attention to the fact that the main expansion has been in other directions. He is inclined to believe that lowering the bond peg will increase the sales of bonds, because of fear, and he doubts whether the insurance companies would cease selling. The insurance companies could be helpful if they would make their investments in capital goods only out of savings and not out of the sale of securities.

Burgess states that there are dangers in the course he has suggested, but the Council cannot afford merely to walk around the problem.

Spencer thinks some insurance companies have stopped selling because they have been talked to by government officials.

E. E. Brown says the election was won with promises for low cost housing and for the support of farm prices. Consequently, the Administration, Congress and the Board of Governors will hardly be inclined, under these conditions, to refuse to carry out their promises.

Fleming thinks that the special reserve plan may be brought out again.

Atwood asks Kemper to express his views on business conditions in his district, as Kemper was not able to be present yesterday when other members of the Council reported on conditions in their respective districts.

Kemper does not believe the bond peg will be dropped. Therefore, it may be better to forget it for the present. He thinks the Board will ask for higher reserves. He also believes we shall have a continuation of wage increases. Kemper believes there is a great deal of powder to explode before the recession begins.

Penick asks whether there is any indication that the inflation has run its course in Kemper's district.

Kemper. The department store sales in his district were off sharply after the election. However, there has been a big crop of corn, and cattle prices are holding quite well.

Burgess states that the point he was making is that you never meet something with nothing. He believes the Council should point out that the problem of inflation exists in the area of durable goods.

Odlin says that if it comes to a question of more bank reserves or government control of insurance companies, he would favor more bank reserves. He greatly dislikes the extension of government authority over any other field.

Penick. If the Board is working for higher reserves, then the Council ought to meet the issue frankly.

Odlin believes that the Board should be notified that the Council will oppose any recommendations the Board makes for increased reserves.

E. E. Brown thinks the Treasury would oppose the special reserve plan if it came up.

Burgess believes the Council should call attention to the area where the problem exists, and that is in durable goods. The Council can at least say, "The coon is up this tree, not that one".

Fleming. The Council can say to the Board that, as we see it at this time, if there is a proposal to increase reserves, we shall oppose it.

E. E. Brown states that his opinion may differ from that of the Council, but he thinks the suggestions made by Sproul on reserves have some merit. Brown is not certain he would necessarily oppose any change in the present law. The primary purpose of reserves is to meet an emergency, and he does not like Leffingwell's idea that you cannot lower reserves in an emergency. However, he does not believe either that the Board should have power to strangle the banks.

Burgess does not think the Council has a closed mind against any change. The increase in reserves is not a method to be used as it was recently. Any proposed change should require long consideration by the Board, the Council and the banks.

J. T. Brown understands that an effort will be made to make the reserve requirements apply both to member and non-member banks, and he thinks that will make plenty of trouble.

Odlin. The Council can state that it has no objection to a consideration of the whole question of reserves.

Woods. The Council could add more emphasis to the idea that banks have not been responsible for the inflation. His bank takes the stand that it is not making speculative loans. He thinks the increase in reserves has tended to restrain credit extension.

Burgess. Are we not in danger then of admitting that increasing reserves has restrained credit?

E. E. Brown thinks that the recent increase in reserves has checked lending in small banks.

Woods agrees.

Burgess assumes that the country banks sold some governments to meet the increased reserve requirements.

Woods reports that the country banks did not sell many securities.

Spencer. The talk of removing the peg probably induced some medium or small-sized banks to sell governments. (At this point several members of the Council suggested that while country banks may not have sold many securities to meet the increase in reserves, they did draw down balances from their correspondents in larger communities and their correspondents in turn had to sell securities).

Woods. If an increase in reserves does restrict credit to any extent, the Council cannot argue that more reserves would not restrict credit further. Finally, with higher and higher reserves, the banks would get to the bottom of the barrel in their ability to lend.

Burgess. It is a deep barrel. Burgess says that Brown has the Council's viewpoint on this question, but the Board may also wish to know the Council's viewpoint regarding the short-term rate. There may be some value in a slight increase in this rate.

E. E. Brown. The sale of long-term governments at present at least has practically stopped, regardless of whether it is due to more confidence that the bond peg will be held, or due to the feeling that recession is imminent. Brown then comments, off-the-record, on certain discussions that have taken place on the bill and certificate rates.

Atwood asks whether a 1 3/8 per cent rate would mean a higher rediscount rate.

Burgess does not believe a 1 3/8 per cent rate would require raising the rediscount rate.

E. E. Brown states that from the discussion which has taken place, he believes the Council is agreed that for the next two or three months, until the situation is clearer, it would not be desirable to change (1) the reserve requirements; (2) the rediscount rate; or (3) the support policy for government securities.

Burgess suggests adding to the summary Brown has given the Council's views on a 1 3/8 per cent certificate rate in January. Burgess would favor raising the certificate rate in January.

E. E. Brown would not be inclined to favor raising the certificate rate in January for the reasons he has given off-the-record. The question is really one of whether the rate should be raised in January; April can be considered when the time arrives.

Burgess says that the Council has previously indicated that it is in favor of a modest increase in the short-term rate.

E. E. Brown agrees that the Council may state to the Board that the Council has been in favor of a modest increase in the short-term rate, but the timing should be a matter of agreement between the Board and the Treasury.

Burgess agrees that the Council should state it does not favor rocking the boat at present although it favors a modest increase in short-term rates. The exact timing should be a matter of agreement between the Treasury and the Board.

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(Brown asks whether any member of the Council has any changes to suggest in the Secretary's mimeographed notes for the meetings held on February 15-17, 1948, April 25-27, 1948, and September 19-21, 1948. There were no suggested changes.)

The meeting adjourned at 12:15 P.M.

The Council convened in the Board Room of the Federal Reserve Building at 2:00 P.M. on November 15, 1948, to hear Dr. Frank A. Southard, Jr., Associate Director of the Division of Research and Statistics of the Federal Reserve Board.

All members of the Council were present.

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E. E. Brown presents Dr. Southard who speaks on the subject "Current Developments in International Finance". An outline of Dr. Southard's talk follows:

CONFIDENTIAL

CURRENT DEVELOPMENTS IN INTERNATIONAL FINANCE

I. The current situation in international finance.

A. Production.

1. On a 1938 base, over-all production index, excluding Germany, reached 116; see attached table. Figures for Germany and Italy should be corrected to take account of the fact that 1938 was peak prewar year for them.

2. Barring setbacks, production should continue increasing.

3. By test of production, Recovery Program is succeeding.

B. Gold and dollar reserves.

1. Still low, except in the United States, Switzerland, and one or two others.

a. Note drain on dollar reserves, e.g., in Latin America, associated with full employment and inflation in contrast with drain due to depression.

2. Rate of drain slowing down because of better crops and fuel production, stricter import controls (e.g., Sweden), some improvement in European exports, some lessening of inflation (United Kingdom, Italy). Also important dollar aid from ERP, IMF, IB, and Ex-Im Bank.

3. But not much rebuilding of reserves--Canada, Italy, Belgium, Venezuela are exceptions.

4. Inflow to United States now running at rate of one billion per year of which, roughly, 300 million would come from reserves.

C. Prices and budgets.

1. World situation generally one of rising prices and budget deficits.

a. But sharp price increases not typical (France, Greece, China, exceptions).

b. Also general progress in reducing budget deficits, in recognition of factor in inflation.

CONFIDENTIAL

LEVEL OF INDUSTRIAL PRODUCTION IN ERP COUNTRIES

QUARTERLY

(1938 = 100)

	Belgium	Denmark	France	Western Germany	Italy	Netherlands	Norway	Sweden	United Kingdom	Over-all index	Over-all index, excluding Germany
1946											
I	77.8	99.0	67.3	23.1	35.3	61.4	92.7	133.5	95.9	67.1	81.1
II	84.8	93.7	82.7	26.4	60.1	68.3	103.3	135.2	100.7	75.1	90.6
III	90.1	104.0	77.0	30.5	71.5	75.9	94.7	132.7	100.4	76.8	91.6
IV	99.2	108.0	89.7	30.0	66.0	88.1	110.0	137.3	110.9	83.0	99.9
1947											
I	102.5	108.3	93.0	25.0	62.2	83.8	113.3	136.3	97.9	77.7	94.6
II	108.2	107.7	100.3	31.9	80.3	89.1	119.0	137.6	111.5	87.4	105.1
III	100.8	114.0	91.3	34.7	90.0	91.1	106.3	136.0	110.9	87.1	103.8
IV	113.1	118.3	95.7	36.1	85.8	105.3	120.0	137.6	121.7	92.6	110.7
1948											
I	115.6	124.0	109.7	38.1	79.5	101.7	125.3	139.6	122.1	95.0	113.2
II	115.2	122.7	114.0	40.3	82.4	106.6	133.3	141.9	124.1	97.6	116.0

2. ERP-area.

   a. Price trends (see Federal Reserve Bulletin) indicate situation not dissimilar to United States, except in France and Greece.

   b. Budget deficits reaching point where could be covered, particularly if ECA local-currency counterpart can be utilized.

      1. Local-currency counterpart problems, particularly with respect to:

         (a) Reduction of debt by use of counterpart.

         (b) Difficulty of obtaining detailed programs for use of ECA, NAC, in passing on release of counterpart.

         (c) Use of the 5 per cent segregation for U.S.

D. Balance-of-payments disequilibrium continues.

   1. Chiefly a dollar gap, everywhere: Europe, Asia, Latin America, Canada.

   2. Also a sterling gap in Europe: Sterling will be scarce by end of 1949.

   3. No systematic figures as to ERP-area global balance.

      a. So far as United Kingdom is concerned, situation relatively good: trade deficit with United States reduced from £21.6 million per month in third quarter 1947 to £9.3 million per month in July and August 1948; and with entire world from £67.9 million to £36.4 million. But the gap is still large and United Kingdom is still losing gold--reserves now below $2 billion.

      b. U.S. trade with 16 ERP countries and Germany showed surplus of $174 million quarterly in 1938, $1,270 million in second quarter 1947, and $839 million in second quarter 1948.

II. Exchange-rate situation.

   A. Mexico as example of full-employment country encountering exchange instability.

      1. The difficult choice: reduce imports, cut back domestic development, balance budget, restrict credit, in order to build up dollar reserves and hold peso steady; or let peso-dollar rate fluctuate.

B. ERP-area.

1. In early stages of recovery effort, some overvaluation justified, with emphasis on imports rather than exports.

2. But time coming when exchange adjustments consistent with balance-of-payments necessities must be faced.

3. Very rough guess is that 1949 is still too early for exchange adjustments on wide scale.

   a. Cited conflict of opinion: Hazlitt, Haberler, Balogh (latter writing in Harris' new book on Economic Foreign Policy).

   b. But some countries (Norway? Sweden? Denmark?) may be ready for adjustment during 1949, provided they can assume sterling-dollar rate will not change. My own hunch is that sterling-dollar rate will <u>not</u> change during 1949.

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The meeting adjourned at 3:30 P.M.

On November 16, 1948, at 10:30 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, and the following members of the Board of Governors were present: Chairman McCabe; Governors Eccles, Szymczak, Draper, Evans, Vardaman and Clayton; also Mr. Carpenter, Secretary of the Board of Governors.

A DISCUSSION OF FURTHER STEPS IN CONNECTION WITH RESERVE REQUIREMENTS, AS WELL AS THE QUESTION OF THE TIMING OF RATES ON SUBSEQUENT GOVERNMENT ISSUES

E. E. Brown states that McCabe telephoned him suggesting that the discussion of the Hoover report be informal and without written statements. The Council believes this procedure is desirable, and in view of the outcome of the election the Hoover report may be less significant than if Dewey had won (Eccles comments,"words of wisdom"). Brown says that it may be desirable to consider the second item on the agenda first, as given above, and discuss the first item on the agenda during the latter part of this joint meeting.

McCabe agrees.

E. E. Brown says that the unexpected outcome of the election has brought at least a temporary reluctance on the part of business concerns in some sections of the country to promote their capital expansion programs. Business is concerned with such questions as the excess profits tax, the Taft-Hartley law and other matters affecting business. The Council believes that business concerns will be inclined to wait on expansion plans until the Administration's program is announced and there is some indication of what Congress will do. The government bond market is stronger, perhaps because of the feeling that the Truman Administration will maintain pegged prices, and also partly because of the feeling that the volume of new corporate securities offered will be less because of the cancellation or postponement of expansion plans. The Council therefore believes that until the trend following the election becomes much clearer, it would be best not to "rock the boat". The Council believes it would not be desirable to change: (1) the reserve requirements, (2) the rediscount rate, and (3) the support prices for government bonds. In connection with the recent increase in bank reserves, the Council believes that the general sentiment of bankers was unfavorable. Increasing the bank reserves is not the proper method of dealing with the problem of inflation. One of the results of an increase in bank reserves under present conditions is simply the transfer of government securities from banks to the Federal Reserve System, thereby nullifying any possible benefits resulting from increasing reserves and making the problem of debt management by the Treasury more difficult. The overall earnings of banks may be satisfactory, but an arbitrary increase in reserves affects the earnings of individual banks adversely. The Council is willing to study the whole question of reserves and the best method of determining the proper reserves. The study should be a comprehensive one embracing all aspects of the subject. The repeated emphasis on bank deposits and on the banks as a major factor in causing inflation gives the public an erroneous impression of the principal causes of the current inflation, which are to be found, for example, in the great expansion in durable goods and in other areas of our economy that have been discussed on previous occasions by the Board and the Council. Attempts to control through monetary policy an inflation which has resulted from conditions largely outside the banking system are certain to be unsuccessful.

The Council appreciates that members of the Board have on some occasions called attention publicly to those factors outside the banking system which are principally responsible for the inflation. If these facts could be reemphasized whenever the occasion permits, it would be very helpful to a better public understanding of the situation. With the conditions now prevailing, any proposals to require still higher reserves, or special reserves for banks, would be opposed by the Council and by bankers generally. In relation to the matter of interest rates on government securities, the Council has at other times stated that under present conditions it would be beneficial to our economy to have a modest rise in short term rates. However, the exact timing of any increase in such rates should be a matter of agreement between the Board of Governors and the Treasury.

McCabe states that he thought an informal discussion on this whole subject would be desirable.

Burgess presents to the members of the Board copies of the figures for expenditures for new durable goods which he had given to the Council previously, and which are included earlier in these notes. Burgess states it is important to emphasize these expenditures so that the public can be educated as to the significance of the durable goods expenditures as they relate to inflation, rather than to place constant emphasis on bank reserves and on banks as the source of the inflation.

McCabe. It is also important to know something of the type of capital expenditures. Some capital expenditures are good and some are bad. McCabe asks whether there is any information on the sale of government securities by insurance companies.

Burgess states he understands there is a distinct pause in the sales of government securities by the insurance companies.

Fleming has been informed that the sales of government securities by insurance companies have practically dried up since the election.

McCabe asks what the Council thinks of the allocation of raw materials.

Burgess states he prefers someone else would speak on this point. He believes that the restrictions may have been removed too soon on the size and type of building.

McCabe. Does the Council feel that the deflationary forces may now be greater than the inflationary forces?

E. E Brown states that the Council does not know. The opinions are mixed. Brown has found some cancellations of expansion programs in his district.

Eccles. The result of the election may have been beneficial. If the election brings a change in psychology, it will accomplish what the monetary authorities have been unable to do. Dewey's election may have meant a boom psychology.

E. E. Brown replies that there may be much to what Eccles has said. Many business men are somewhat apprehensive.

Evans. How soon will they get over this feeling?

E. E. Brown. It depends on the program the Administration announces and the attitude of Congress.

McCabe feels that to a certain extent the present attitude of business may be helpful.

Draper thinks it may be helpful if it does not go too far.

Spencer comments that the absence of a good equity market has meant more bank loans.

Eccles. We are trying to make up the backlog of shortages in various fields much faster than we should. The volume of credit we now have should be more than sufficient to meet our needs. Banks have expanded credit, whereas the government has reduced the supply of money. The banking system has completely nullified the government program. The attitude of the banks is one of trying to blame inflation on everyone else but the bankers. The bankers should assume their share of the responsibility, because the backbone of an inflation is money. The Board did not have the opportunity to restrict credit after World War II as was done after World War I.

Fleming states that Eccles has not given the complete facts back of the situation. At the end of World War II there was a fear that we might have eight million persons unemployed. Higher wages were granted, and every encouragement was given to prevent an anticipated depression.

Eccles. The government did promote housing and state and local governments did make large expenditures. The Council previously recommended no increase in the reserves. The Board had to increase the reserves or withdraw the support of the peg. The last reserve increase merely sterilized the inflow of gold and the purchase of securities from insurance companies and others. If reserves had not been increased, the banks could have expanded credit further.

Fleming. How can the cost of living be reduced with support prices for food?

Eccles. Prices are not down to the support prices.

J. T. Brown. What effect has government lending to a bank for cooperatives and the C.C.C. in promoting the inflation? If the government did not make loans, the cotton would be sold. Cotton is being put under the loan at prices above the market.

Odlin states that he does not wish Eccles' remarks to go without further disagreement with the views Eccles has expressed. The price mechanism performs an important function in our economy. An inflation cannot be stopped simply by increasing reserves.

Burgess. Credit expansion cannot be stopped as long as the spigot is open so insurance companies can sell government securities. Insurance companies sell their government securities and place the proceeds in the economy. If there is a volume of capital goods expansion, it will require bank credit. Banks are obligated to grant credit to customers to carry on their businesses after their capital goods expansion is an accomplished fact. Emphasis is being erroneously placed on the banks as the cause of all the trouble.

Szymczak. Assuming the insurance company selling and the capital goods expansion cannot be stopped, what else can be done?

Burgess. The United States government has done nothing to curtail its own capital expenditures.

Szymczak. Just what can the Board do about Congress when the public has apparently approved further expenditures?

Fleming reads figures from the monthly letter of the National City Bank of New York for November 1948, showing that the biggest suppliers of new funds to the corporate bond and mortgage market this year have been the life insurance companies.

Eccles. The insurance companies are the worst offenders. We are in a dilemma on this problem.

McCabe comments that this is an unusual situation where the regulatory body sits with those to be regulated and discusses major phases of the regulations. As the world and the United States drift to the left, it is important to preserve this freedom of discussion.

Fleming. Only a few years ago everyone said the banks were not extending credit and now the responsibility for the inflation is blamed on them. There is a danger that the banker may be placed in the doghouse, and then the next step may be the government extension of credit. When that happens, the free enterprise system is through.

Odlin asks whether the Board anticipates requesting more power over bank reserves; if so, the Council would like to have time to arrange a caravan to come to Washington to appear against the proposal

McCabe. The Board has not had a meeting yet on the subject.

THE QUESTION OF THE REORGANIZATION OF FEDERAL CREDIT AGENCIES IN VIEW OF THE ACTIVITIES OF THE HOOVER COMMITTEE

Brown states that the Council finds itself in agreement on a number of major principles relative to the Federal banking and credit agencies. (1) The Council believes in the maintenance of the dual banking system. No change should be made which would weaken this system. The checks and balances which a dual banking system provides have been constructive. The Bach report states that all banks should logically be under Federal control,but it says that politically this is not possible. (2) The Council realizes the problem of maintaining the independence of the Board while providing at the same time reasonable cooperation with the Administration. It is imperative that the Board have reasonable independence of thought and action. It should not be subservient to the Treasury and to every change in the viewpoint of the Treasury. However, the Board should, whenever possible, find practical means of cooperating with the Treasury in the development of sound fiscal and monetary policies. The suggestion in the Bach report for reducing the size of the Board to five, including an Assistant Secretary of Banking in the Treasury, is not desirable, as it would reduce the importance of the Board. (3) The Council also does not agree with that portion of the Bach report which favors the establishment of an Economic Council. An Economic Council would reduce the importance of the Board. Moreover, the government has power to create a council now, without asking for legislation. (4) The Council favors substantially higher salaries for the members of the Board of Governors. (5) The Council believes that the maintenance of the independence of the individual Federal Reserve banks is of special importance, including such matters, for example as the election of a president of a Federal Reserve bank by its directors and the participation by the presidents of the Federal Reserve banks in the activities of the Open Market Committee. (6) The Council opposes combining the functions of bank supervision and examination with the objectives of fiscal and monetary policy. Bank examinations should be objective and should not be used to carry out fiscal and monetary policies. Bankers may feel impelled on occasion to criticise Federal Reserve policy, and they may be reluctant to do so if bank supervision is interrelated with fiscal and monetary policy. Bankers who are critical may fear retaliation in bank examinations. Freedom of speech may be restricted to the detriment of the banking system.

McCabe expresses appreciation for Brown's analysis of the Bach report and states that the analysis was most comprehensive and helpful. He states that the Board has not made a study of the Bach report. If the analysis that Brown has made could be studied point by point, it would be very much worthwhile. He wonders if everyone has an understanding of the dual banking system and its limitations. He asks what there is that could be done to make the dual banking system more constructive and make it work better.

Odlin states he believes it works well now.

McCabe. Bankers in the small banks question the value of the Federal Reserve System.

Atwood. It may be the matter of reserves which concerns them.

McCabe replied that reserves do concern particularly the small banks, but despite the recent increase in reserves, the System has a gain in members. He asks what can be done to make the System better.

Atwood. One thing that can be done is not to increase the reserves further.

E. E. Brown points out that competitive pressures in the dual banking system have brought improvements in banking. He doubts whether small banks in small cities do obtain real advantages from membership in the Federal Reserve System. On the other hand, there are a number of good-sized State banks that should belong. He does not believe membership should be compulsory.

J. T. Brown. There is no real reason for some small banks to belong to the System. They make their income from small charges. Membership in the System would give them all the disadvantages and none of the advantages.

McCabe. Would it be advisable to make non-member banks subject to the same reserve requirements as member banks?

J. T. Brown. It would be greatly opposed.

McCabe. The small member banks favor making reserve requirements apply to the non-member banks.

J. T. Brown thinks there is some selfishness in this viewpoint.

McCabe asks what the Council would say to the small member banks who complain of the disadvantages of the System.

J. T. Brown. There are disadvantages in exchange requirements, reserve requirements, and loan limitations. There is room in our economy for both member and non-member banks.

Vardaman. **Should** the question of deposit insurance play a part? Should a bank having government insurance be required to have membership?

J. T. Brown. The F.D.I.C. was the result of a national emergency. The banks own the Federal Reserve System.

Szymczak differs with J. T. Brown's viewpoint and states that only in a sense do the banks own the System.

McCoy. The small state banker remembers 1933. He remembers the Federal Reserve bank required every non-member bank to ship currency in that period. A non-member bank can operate satisfactorily.

Fleming. If a small non-member bank carries correspondent accounts from which it gets special services, it hesitates to split its balances and give part of them to the Federal Reserve bank from whom it cannot get such personal service.

Penick. A small non-member bank can carry a clearing account with a Federal Reserve bank and get almost all the advantages of membership.

McCabe states that in Philadelphia he heard comments that the large city banks had urged small banks to withdraw from membership.

Williams. The Federal Reserve bank in the third district is making a real effort to sell bankers on the value of membership in the System.

Atwood states that the situation is very competitive in the ninth district with the Federal Reserve bank giving forums, parties, and arranging other activities of interest to the bankers.

Fleming states that politically it is impossible to get all bankers in one system.

E. E. Brown suggests that some consideration be given now to the question of the independence of the Board of Governors. History has shown that a central bank cannot be completely independent. It may be said that the Board must go along with the Administration and be a department of the Treasury, but the Council believes it is highly desirable to have the maximum amount of independence in the Board. The Board must recognize, however, that if it opposes an Administration too strongly, ways will be found by that Administration to meet the situation. Appointments may be made to the Board so that they run out every two years, and there may be pressure for resignations. Such a scheme as the Bach report suggests of having an Assistant Secretary of the Treasury for Banking is not desirable. The Secretary of the Treasury was at one time a member of the Board. He attended meetings when important matters were being considered, and sometimes perhaps dominated the discussion without knowing the facts. At other times the Secretary of the Treasury sent an Assistant Secretary of the Treasury. The Council does not favor reducing the number of members of the Board, as it believes the Board's influence would be weakened.

Fleming. Every time a new President took office he might wish to reduce or change the number of members of the Board.

McCabe. As a Board we have not discussed the Bach report.

Evans thinks the Council made an exceptionally good statement on the Bach report.

E. E. Brown reports that the Council can see no advantage in the proposal for an Economic Council.

Eccles. In connection with the discussion on the independence of the Board, the question is "independence of what?" According to the statement of the Council the Board is not to increase reserves; it is not to change the rediscount rate; it is not to change the pegged bond prices. The Board is not to increase membership in the Federal Reserve System. The Council believes merely that the status quo should be maintained. Eccles then reads the following statement made by Senator Glass in 1913:

Cong. Rec., House of Representatives, September 10, 1913
(Mr. Glass speaking)

"The aim of this measure is to transfer these reserves away from banks other than those to which they belong, so that ultimately bank reserves will be held partly in the vaults of the banks to which they belong, and partly in the regional reserve banks, the reserve banks taking the place of existing reserve city and central reserve city banks in their relation to member banks."

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Eccles continues by reading the following comment from the Annual Report of the Board of Governors for 1915.

"*** 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."

J. T. Brown. The Supreme Court in the Richmond case said the foregoing statement did not express the purpose for which the Federal Reserve System was established.

Eccles. Selling the services of the Federal Reserve System to non-members is extremely difficult. The Federal Reserve banks are in no position to compete with the services of the correspondent banks.

J. T. Brown states that every time he has convinced a small bank that it ought to join the System, some item appears in the press about some new proposal of the Board of Governors. Such statements seldom, if ever, appear from the offices of the Comptroller of the Currency or the FDIC. J. T. Brown finds that often after a small bank has about decided to join the System, it changes its decisi n when it reads in the press about further plans of the Board of Governors.

(At this point, 1:05 P.M., the meeting adjourned for luncheon, after which the meeting was reconvened at 2:10 P.M.)

McCabe asks about the Council's views on the suggestion for a National Monetary Commission.

E. E. Brown. The Council believes it would be unwise now to have a National Monetary Commission, as it would serve no useful purpose.

If an objective group could study the whole question of bank reserves, it would be helpful. The primary purpose of reserves has been to have them available for use in a national emergency.

McCabe. Unless a commission has a great many bankers on it, it is apt to come up with some new proposals. He thinks each new commission tends to break down checks and balances.

E. E. Brown. In a National Monetary Commission you would have Congressmen as members or you would go outside and include bankers, in which case other groups, such as labor, would insist upon participation in the work of the Commission. The Commission then probably would not be an objective one. In connection with the matter of salaries, the Council favors larger salaries for the members of the Board.

McCabe. Higher salaries for the Board members would also mean higher salaries for members of the staff.

E. E. Brown. The Council believes in considerable independence for the individual Federal Reserve banks, including such matters, for example, as the election of the president of a Federal Reserve bank by its directors, and the participation by the presidents of the Federal Reserve banks in the activities of the Open Market Committee. There have been cases where the presidency of a Federal Reserve bank has been held open to take care of a political situation in Washington.

McCabe thinks the idea in the Bach report of the Board appointing the presidents of the Federal Reserve banks is wrong.

Eccles states he does not know where Bach got the idea.

McCabe. In many of the Federal Reserve banks it is unfortunate that the bankers have taken no real interest in the election of the directors. He cites the case of the Federal Reserve bank of New York as one in which the bankers have taken a real interest in the election of the directors. McCabe recommends that in each district a live nominating group be set up to nominate the directors.

E. E. Brown states that the Council favors having the presidents of the Federal Reserve banks participate in the work of the Open Market Committee as at present.

McCabe. The Board is in agreement with the Council on this matter.

E. E. Brown. The Bach report favors combining examinations, although it admits that the amount to be saved would be small. The report also urges combining examination and policy-making. The Council recalls that Eccles has urged easing credit in periods of depression and tightening credit in boom periods; the Council also recalls that Eccles has suggested using examinations to accomplish these objectives. The Board's duty is to fix monetary policy, and if a banker criticised the policy he might be subject to retaliation through examinations, if the policy-making body also conducted the examinations.

Eccles states that the Council is familiar with his views on this question.

E. E. Brown replies that the Council understands them, as Eccles has expressed them strongly on previous occasions.

Eccles asks how the Board can have any policy if it cannot change reserves, the rediscount rate, or support prices and also is to have no authority over examinations. Based on experience, monetary policy and examination are inseparable. If the Board is to contribute to the economic stability of the country within the scope of monetary policy, it must have authority over examinations.

McCabe believes there is close cooperation now between the examining agencies.

Vardaman states that some of those in favor of a National Monetary Commission thought it might be used as one means of combating any wild ideas that might come from the Hoover report.

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The meeting adjourned at 3:10 P.M.

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As the meeting was to adjourn the members of the Board stated that the President had asked them for recommendations for possible legislation and that these recommendations would have to be submitted within a few days. The Board said the Council could submit to the Board any recommendations it wished to make.

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The Executive Committee of the Council met at 3:17 P.M. in the conference room of the Board Building. All members were present except Fleming, but Brown informed Fleming later in the day of the discussion.

The Committee discussed the subject matter of a possible statement that might be prepared and given to the Board relative to the Board's recommendations to the President. The Secretary of the Council will send all members of the Council, as soon as it is available, any statement the Executive Committee of the Council may submit to the Board of Governors.

The Executive Committee meeting adjourned at 3:50 P.M.

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The Council and the Board agreed that the next meeting would be held on February 13-15, 1949.

MEMORANDUM

to the

BOARD OF GOVERNORS
from the
FEDERAL ADVISORY COUNCIL

November 22, 1948

The unforeseen outcome of the election has brought at least a temporary reluctance on the part of business concerns in some sections of the country to promote further capital expansion programs. This hesitation to proceed with business plans will probably continue until the Administration program relating to taxes, labor legislation, and other measures concerning business has been announced and the attitude of the new Congress can be appraised. The election has also affected the security markets. The government bond market has been stronger, partly because of the feeling that the Administration will maintain the present support policy for government securities, and partly because of the feeling that it is likely the volume of new corporate securities offered will be less because of the cancellation or postponement of expansion plans and that a government bond yielding $2\frac{1}{2}$ per cent may be an attractive investment in comparison with the probable yield on the reduced supply of high grade corporates.

The members of the Council do not now find any clear and uniform economic trend evident throughout the twelve Federal Reserve districts. The Council, therefore, believes that until the trend following the election becomes much clearer, it would not be advisable "to rock the economic boat". Specifically, the Council believes it would not be desirable under present circumstances to change (1) the reserve requirements, (2) the rediscount rate, or (3) the support policy for government securities.

The Council further believes that increasing bank reserves is not the proper method of dealing with the problem of inflation. One of the results of an increase in bank reserves under current conditions is the transfer of government securities from banks to the Federal Reserve System, thereby largely nullifying any possible benefits from increasing the reserves and making the problem of debt management by the Treasury more difficult. An increase in member bank reserves not only makes membership in the System less desirable, but it also affects the earnings of some banks adversely. The overall earnings of banks may be satisfactory, but the arbitrary character of an increase in reserves in all banks affects the earnings of individual banks unfairly.

The repeated emphasis on bank deposits and on the banks as a major factor in causing inflation gives the public an erroneous impression of the principal reasons for the current inflation, which are to be found in the great expansion in the production of durable goods including housing and in large expenditures for defense, foreign aid and veterans' assistance. Attempts to control through monetary policy an inflation which has resulted from conditions largely outside the banking system are certain to be unsuccessful.

The Council appreciates that members of the Board have on some occasions called attention publicly to those factors outside the banking system which are principally responsible for the inflation. If these facts could be reemphasized whenever the occasion permits, it would be very helpful to a better public understanding of the situation.

With the conditions now prevailing, any proposals to increase reserves under the present authority, to request additional authority to impose still higher reserves, or to seek authority for special reserves for banks would in view of the foregoing comments be opposed by the Council, and by bankers generally, as detrimental to the best interests of the economy.

The Council believes it would be helpful if a comprehensive study could be made of the whole question of bank reserves, including such subjects as the purposes bank reserves serve, whether authority to vary reserves should be granted or whether they should be fixed definitely by legislation, and the proper relationship of reserves to the various classes of deposits, and to the size and location of banks. This study might be undertaken by a committee including representatives of the banking agencies of the Federal government, the banking departments of the state governments and the banks. An objective and exhaustive study in this field would be a useful guide to ultimate legislation.

In relation to the matter of interest rates on Government securities, the Council has at other times stated that under present conditions it would be beneficial to our economy to have a modest rise in short term rates. Even a small increase in these rates is helpful in reducing the demand for credit by making both borrowers and bankers aware of the dangers in the present situation. The timing of any increase in such rates should be a matter of agreement between the Board of Governors and the Treasury.