MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

October 1, 1950

The third statutory meeting of the Federal Advisory Council for 1950 was convened in Room 932 of the Mayflower Hotel, Washington, D. C., on October 1, 1950, at 2:10 P.M., the President, Mr. Brown, in the Chair.

Present:

Walter S. Bucklin	District No. 1
Frederic A. Potts	District No. 3
Sidney B. Congdon	District No. 4
Robert V. Fleming	District No. 5
J. T. Brown	District No. 6
Edward E. Brown	District No. 7
W. L. Hemingway	District No. 8
Joseph F. Ringland	District No. 9
David T. Beals	District No. 10
DeWitt T. Ray (Alternate for J. E. Woods)	District No. 11
James K. Lochead	District No. 12
Herbert V. Prochnow	Secretary

Absent:

N. Baxter Jackson	District No. 2
J. E. Woods	District No. 11

On motion duly made and seconded, the mimeographed notes of the meeting of the Council held on May 14, 15 and 16, 1950, and of the meetings of the Executive Committee held on August 1, 1950, and September 13, 1950, copies of which had been sent previously to the members of the Council, were approved.

President Brown reviewed the subjects discussed at the meetings of the Executive Committee of the Council held August 1 and September 13, 1950.

A complete list of the items on the agenda for the meeting and the conclusions of the Council are to be found in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council,* which follows on pages 28 and 29 of these minutes.

In addition, it was agreed that the Council ask the Board what steps it had taken to obtain voluntary cooperation to curtail credit in accordance with the provision of Public Law 774. Furthermore, it was agreed to pursue the subject with Dr. Stonier of the American Bankers Association.

The meeting adjourned at 6:05 P.M.

HERBERT V. PROCHNOW
Secretary.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

October 2, 1950

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. Walter S. Bucklin, N. Baxter Jackson, Frederic A. Potts, Sidney B. Congdon, Robert V. Fleming, J. T. Brown, W. L. Hemingway, Joseph F. Ringland, David T. Beals; DeWitt T. Ray (Alternate for J. E. Woods); James K. Lochead, and Herbert V. Prochnow, Secretary.

Absent: Mr. J. E. Woods.

The Council reviewed its conclusions of the previous day regarding the items on the agenda and sent to the Secretary of the Board of Governors the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council,* which follows on pages 28 and 29, listing the agenda items with the conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 11:50 A.M. on October 2, 1950.

The meeting adjourned at 12:00 A.M.

HERBERT V. PROCHNOW
Secretary.

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE JOINT MEETING ON OCTOBER 3, 1950

1. What further consideration has been given by the Council, or the Special Committee appointed by the Council for the purpose, to the proposal to base reserve requirements of a member bank on the character of the bank's deposits rather than on the location of the bank?

The Council has considered further the proposal to base reserve requirements of a member bank on the character of the bank's deposits rather than on the location of the bank. When the proposal was discussed with the Board in February, 1950, it developed that one of the first matters requiring consideration would be the problem confronting the livestock banks. No formula or agreement in principle has so far been developed for meeting this problem. In addition, under the proposal a considerable percentage of country banks would have been required to maintain higher reserves if total over-all reserves are maintained at the present level. It was apparent that to obtain acceptance of the proposal from the country banks it would be necessary initially at least to reduce over-all reserves. With present inflationary trends, a reduction in over-all reserves would obviously be undesirable.

In view of prevailing unsettled conditions, any proposal for changing the method of determining bank reserves would be disturbing to the banking system at a time when the complete cooperation of the banks is necessary to the efficient functioning of the economy. The method now used to determine reserves is thoroughly familiar to the banks, and the banking system has for many years operated effectively under it. The Council therefore does not favor a change to the uniform reserve proposal at this time.

Before any steps are taken to request authority to increase maximum statutory reserve requirements, the results of the regulation of consumer credit, including more stringent consumer credit regulation, and the results of the regulation of real estate credit should be studied and evaluated. Cooperative voluntary restrictions in the extension of inflationary credit, authorized and intended by the Defense Production Act of 1950 and the President's directive of September 9, 1950, giving control over agreements for such voluntary restrictions to the Board, should be tried with the cooperation of banking and other financial associations. We recommend that prompt steps be taken by the Board to initiate and stimulate such voluntary agreements.

If economic conditions should thereafter clearly necessitate any change in maximum statutory reserve requirements, the Council is unanimously of the opinion that no special reserve in any class of government securities should be adopted, but that the pattern used in 1948 should be followed, extending temporary authority for increased maximum cash reserves, with the present division for reserve purposes of central reserve, reserve and country banks continued. Any authority granted should be for a period not to exceed two and a half years so Congress would have the right to review the matter.

2. In accordance with the discussions between Chairman McCabe and President Brown, it is understood that the Council will be prepared to discuss the reduction to two days of the maximum deferment for cash items.

The Council believes in time schedules which are actual and not artificial. Availability should be as prompt as it is possible to make it with the best transportation facilities, but it is an unsound practice to give credit for reserve purposes for an item before it is actually collected. Apart from the fundamental principle that an item should not be credited until it has reached its destination and has been collected, the proposed reduction to two days of the maximum deferment for all cash items would result in more float, and thus in more inflation at a time when efforts are being made to curb inflationary trends. The Council therefore does not favor the proposed reduction to two days of the maximum deferment for all cash items.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

October 2, 1950

At 2:20 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. Walter S. Bucklin, N. Baxter Jackson, Frederic A. Potts, Sidney B. Congdon, Robert V. Fleming, J. T. Brown, W. L. Hemingway, Joseph F. Ringland, David T. Beals; DeWitt T. Ray (Alternate for J. E. Woods); and Herbert V. Prochnow, Secretary.

Absent: Messrs. J. E. Woods and James K. Lochead.

President Brown presented Dr. Woodlief Thomas of the Staff of the Board of Governors, who in turn introduced a number of other members of the Board Staff, who made a visual-verbal presentation on "The Current Economic Situation and Outlook".

The meeting adjourned at 3:25 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

October 3, 1950

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

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

Chairman Thomas B. McCabe; Governors Marriner S. Eccles, M. S. Szymczak, R. M. Evans, James K. Vardaman, Jr., Edward L. Norton, and Oliver S. Powell; also, S. R. Carpenter, Secretary of the Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Messrs. Walter S. Bucklin, N. Baxter Jackson, Sidney B. Congdon, Robert V. Fleming, J. T. Brown, W. L. Hemingway, Joseph F. Ringland, David T. Beals; DeWitt T. Ray (Alternate for J. E. Woods); James K. Lochead and Herbert V. Prochnow, Secretary.

Absent: Messrs. Frederic A. Potts and J. E. Woods.

President Brown read the first item on the agenda and the conclusions of the Council as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council,* as printed on pages 28 and 29 of these minutes.

An extended discussion followed on reserve requirements, and the general problem of inflation.

The President of the Council then read the second item on the agenda, and the conclusions reached by the Council, as expressed in the *Confidential Memorandum* previously mentioned, after which there was a brief discussion of the item.

The meeting adjourned at 1:32 P.M.

HERBERT V. PROCHNOW
Secretary.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

October 3, 1950

At 2:40 P.M., the Federal Advisory Council reconvened 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. Walter S. Bucklin, Sidney B. Congdon, Robert V. Fleming, J. T. Brown, W. L. Hemingway, Joseph F. Ringland, David T. Beals; DeWitt T. Ray (Alternate for J. E. Woods); James K. Lochead and Herbert V. Prochnow, Secretary.

Absent: Messrs. N. Baxter Jackson, Frederic A. Potts and J. E. Woods.

After some discussion as to the best method of making the agreements for voluntary cooperation effective, it was decided that as a preliminary step, Messrs. Fleming and Hemingway would talk with Dr. Stonier of the American Bankers Association. In addition, it was agreed that President Brown would discuss the matter with James E. Shelton, President of the American Bankers Association.

The meeting adjourned at 3:25 P.M.

HERBERT V. PROCHNOW
Secretary.

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 Council. The concise official minutes for the entire year are printed and distributed later.

H. V. P.

The Secretary's notes on the meeting of the Federal Advisory Council on October 1, 1950, 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. Jackson and Mr. Woods. Mr.De Witt T. Ray served as an alternate for Mr. Woods.

The Council approved the Secretary's notes for the meeting of the Council on May 14, 15, and 16, 1950, and for the meetings of the Executive Committee of the Council on August 1 and September 13, 1950.

REVIEW OF SUBJECTS DISCUSSED AT THE EXECUTIVE COMMITTEE MEETINGS OF THE COUNCIL HELD ON AUGUST 1 AND SEPTEMBER 13, 1950.

E. E. Brown. Before considering the items on the agenda, E. E. Brown reviews the subjects discussed at the meetings of the Executive Committee of the Council held August 1 and September 13, 1950. The members of the Council have each received a copy of the Board Report to the Joint Committee on the Economic Report on "Fiscal and Credit Policies in Present Emergency." The preliminary draft of this report was the subject of discussion at the Executive Committee meeting on August 1. Brown discusses the difficulties confronting the Board in the preparation of Regulation X dealing with real estate controls. The most perplexing problem in connection with real estate controls relates to loans to industrial and commercial concerns. Brown mentions also the discussion by the Executive Committee with the Board relative to voluntary cooperation on the part of commercial banks, investment concerns and insurance companies to restrict the extension of large loans for longer periods where such loans might be considered inflationary in character. He calls attention to the inclusion in Public Law 774 and the Executive Order of the President of September 9, 1950, of sections relating to voluntary cooperation.

Lochead thinks that the real estate credit situation has many dangers in it. It could be the route by which socialism would enter the American economy as it did in England.

Fleming comments that Mr. Fisher is an excellent person to sit in on the hearings on real estate controls.

E. E. Brown states that it is hard to regulate real estate loans to large industries when a portion of any commercial loan to a large industry may be used for construction. It is difficult to work out good credit controls for residential construction, but it is an infinitely greater problem to work out any satisfactory regulation covering commercial and industrial credit relating to real estate construction. E. E. Brown reports that on September 13, the Executive Committee expressed the opinion that Regulation W would have to be tightened to be effective.

(At this point there was an off-the-record discussion on the relationship of the Board of Governors with the Treasury. Interest rates on government obligations, the rediscount rate, open market operations, and other related subjects were included in the off-the-record discussion).

WHAT FURTHER CONSIDERATION HAS BEEN GIVEN BY THE COUNCIL, OR THE SPECIAL COMMITTEE APPOINTED BY THE COUNCIL FOR THE PURPOSE, TO THE PROPOSAL TO BASE RESERVE REQUIREMENTS OF A MEMBER BANK ON THE CHARACTER OF THE BANK'S DEPOSITS RATHER THAN ON THE LOCATION OF THE BANK?

E. E. Brown asks Fleming, as Chairman of the subcommittee of the Council on this subject, to comment on this item on the agenda.

Fleming. The subcommittee of the Council was confronted with the consideration of two questions: (1) Could the uniform reserve proposal be changed to eliminate the problems with which the livestock banks were confronted; and (2) What could be done to meet the problem of higher reserves which would be required of a number of country banks. A meeting was held in Kansas City regarding which Mr. Beals has previously reported.

Beals states that at the Kansas City meeting it was agreed that the Federal Reserve Staff was to try to find solutions for some of the problems raised. Representatives of the Federal Reserve banks and of the livestock banks were present. No word has been received from the Federal Reserve Staff since that meeting.

Fleming states that he talked with Woodlief Thomas of the Staff, and Thomas did not think it was advisable to go any further with this reserve proposal at present. Thomas did not know the item was on the agenda. This item may have been put on the agenda for the purpose of opening up the whole question of reserves, although a top staff man, Woodlief Thomas, believes consideration of this subject should be held in abeyance.

Hemingway read the following report which was adopted by the Advisory Committee on Special Activities of the American Bankers Association: "It was unanimously agreed by the Committee to recommend that in view of the present critical foreign situation, which requires fullest cooperation by the banks, any plan for changing the method of determining bank reserves, such as the Uniform Reserve Plan outlined by the Staff of the Board of Governors of the Federal Reserve System, or the Special Reserve Plan providing compulsory investment by the banks in government securities, would be disturbing to the banks and the economy, and that it would therefore be much more effective to adhere to the present system of determining reserves, which is so well understood and is working without serious friction."

E. E. Brown. The resolution apparently favors the present plan.

Hemingway. Yes, that is the intent.

E. E. Brown questions whether modest increases in the interest rate will materially restrict credit or that Regulation W, with the present terms, will greatly curtail credit. Some increase in reserve requirements may be found necessary if the inflationary trend continues. It may be desirable in the Council's memorandum to follow the suggestion of the A.B.A. resolution, which Hemingway has read, of keeping the present reserve method, although it may be considered unfair to the central reserve city banks and to some reserve city banks. Brown states that if the special reserve idea is adopted he would not favor a special type of security for the special reserve, but would favor regular short-term issues for the special reserve. He believes if a special reserve should be approved that it would be undesirable to have one type of issue for the public and a different type of issue for the special reserve.

Fleming believes the special reserve idea is bad because it opens the way to the socialization of banks. He agrees with E. E. Brown that any increase in reserves should be made on the basis of the present plan, that is, central reserve, reserve, and country banks rather than to institute a special reserve.

J. T. Brown comments that the idea of the Comptroller that a bank should not have risk assets to capital in excess of a certain ratio is approaching the special reserve backwards and in a sense amounts to the same thing.

Hemingway states that the Comptroller's idea is to take the total assets, deduct the cash and governments and call the other assets "risk assets." He understands that the ratio which has been discussed is 6 or 6½ times the capital.

E. E. Brown says that Robertson did not mention the 6 or 6½ ratio in his prepared speech before the American Bankers Association Convention, but did mention the ratio in a special conference with questions and answers. If the banks are faced with an increase in reserves, no interest would be paid on cash reserves. With a special reserve, interest would be paid. It is possible to have a special reserve with regular short-term governments eligible for the reserve, or a special reserve with only a particular type of security issued for this reserve. Brown favors the cash reserve, despite the loss of interest, over either type of special reserve, because of his fear of what a special reserve might eventually lead to for the banking system.

Bucklin asks if Brown is speaking of a reserve over and above the present maximum limits.

E. E. Brown states that he is speaking of a reserve over the present maximum if a higher reserve should temporarily become necessary.

Fleming. If it becomes necessary, Fleming favors a temporary increase in cash reserves following the 1948 pattern. He does not favor burying the uniform reserve plan, but at present he believes it is not desirable to change the method of determining reserves.

E. E. Brown states that in the memorandum of the Council to the Board, the Council may point out that under the uniform reserve proposal over-all reserve requirements would be reduced. It would be necessary to reduce reserve requirements for the country banks in order to obtain adoption of the proposal. With the present inflationary trend any reduction in reserves is undesirable. In addition, the livestock banks have been dealt with unfairly in the Staff proposal, and the Staff has presented no formula for meeting the problem of the livestock banks. If there is to be an increase in the maximum statutory reserves, it should follow the present plan under which reserves are based upon the classification of banks as central reserve, reserve, and country banks. The memorandum of the Council to the Board may also state the Council is unanimously of the opinion that if any increase in the maximum statutory reserves is clearly necessary, the increased reserves should follow the pattern of 1948, with authority given to increase reserves for a period not to exceed $2\frac{1}{2}$ years so Congress could have the right to review the authority. Moreover, before considering any increase in the maximum statutory reserve requirements, careful study should be made of the effect of the regulation of consumer credit, including a tightening of the consumer credit regulation, and the effect of the regulation of real estate credit.

Potts asks whether the Council favors laying this proposal on ice.

Bucklin thinks it is necessary only to say that at the present time the Council does not favor a change to the uniform reserve proposal.

Ray. Does the Council favor an immediate increase in reserves over the present legal maximum reserve requirements?

E. E. Brown. The Council only favors an increase in the maximum statutory reserves if the financial situation clearly makes an increase desirable. In that event, the increase should follow the present method of determining reserves.

IN ACCORDANCE WITH THE DISCUSSIONS BETWEEN CHAIRMAN MCCABE AND PRESIDENT BROWN, IT IS UNDERSTOOD THAT THE COUNCIL WILL BE PREPARED TO DISCUSS THE REDUCTION TO TWO DAYS OF THE MAXIMUM DEFERMENT FOR CASH ITEMS

E. E. Brown reads item two on the agenda and states that the Board of Governors had voted to put into practice the reduction to two days of the maximum deferment for cash items. Brown had suggested to the Board that the actual adoption of this time schedule should be deferred until the Council could discuss the matter. Under present conditions, anything that increases availability adds to inflation. The Chicago banks are not enthusiastic about the proposal but might not fight it. The proposal is uneconomic and unsound as it gives credit to an item before it is actually collected.

Congdon. It is uneconomic and unsound.

E. E. Brown. The Board of Governors believes it would save a great deal of bookkeeping.

Fleming. It means that national companies would have funds available to them before they were collected, and their treasurers would naturally take advantage of that situation.

Lochead. No matter how the Council votes, the Board will probably adopt the procedure.

J. T. Brown presents figures showing that the float in the System with the two day plan would be increased around $100 million. He states that the Board talks on one hand against inflation and then on the other hand argues for this measure which is inflationary. A number of the districts have two day availability within the districts. From a selfish standpoint, his bank would probably be helped, but he believes the procedure would be unsound.

Fleming. Availability should be as prompt as it is physically possible to make it. Immediate availability would mean keeping a credit file on every name.

Ray. The Board could go to one day as easily as two days.

Bucklin. The proposal is inflationary and economically unsound.

E. E. Brown. The Council does not object to a time schedule which is actual. Present time schedules have been shortened with improvements in transportation. A city in Maine obviously may not be able to collect an item in two days in Arizona. The Council may state it is opposed to any plan which gives credit for funds not actually collected. Apart from the fundamental proposition that an item should not be credited until it has reached its destination and has been collected, the proposed reduction to two days would result in more float and in more inflation.

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E. E. Brown:

In connection with the restriction of bank credit Brown asks who should take the lead in obtaining voluntary cooperation to curtail credit in accordance with the provisions of Public Law 774.

Fleming believes it advisable to ask the Board what steps it has taken. He also suggests that he will ask Stonier about A. B. A. participation in the general program for the restriction of bank credit.

The meeting adjourned at 6:05 P.M.

THE COUNCIL CONVENED AT 10:00 A.M.,ON OCTOBER 2, 1950 IN ROOM 932 OF THE MAYFLOWER HOTEL, WASHINGTON, D. C. ALL MEMBERS OF THE FEDERAL ADVISORY COUNCIL WERE PRESENT EXCEPT MR. WOODS. MR. DE WITT T. RAY SERVED AS ALTERNATE FOR MR. WOODS.

The Council continued its off-the-record discussion of the previous day on the relationship of the Board of Governors to the Treasury. Interest rates on government obligations, the rediscount rate, open market operations and other related subjects were included in the discussion.

The Council prepared and approved the attached Confidential Memorandum to be sent to the Board of Governors relative to the Agenda for the joint meeting of the Council and the Board on October 3, 1950. The Memorandum was delivered to the Secretary of the Board of Governors at 11:50 A.M. on October 2, 1950. It will be noted that each item of the agenda is listed with the comments of the Council on the item.

The meeting adjourned at 12:00 A. M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON OCTOBER 3, 1950

1. What further consideration has been given by the Council, or the Special Committee appointed by the Council for the purpose, to the proposal to base reserve requirements of a member bank on the character of the bank's deposits rather than on the location of the bank?

The Council has considered further the proposal to base reserve requirements of a member bank on the character of the bank's deposits rather than on the location of the bank. When the proposal was discussed with the Board in February, 1950, it developed that one of the first matters requiring consideration would be the problem confronting the livestock banks. No formula or agreement in principle has so far been developed for meeting this problem. In addition, under the proposal a considerable percentage of country banks would have been required to maintain higher reserves if total over-all reserves are maintained at the present level. It was apparent that to obtain acceptance of the proposal from the country banks it would be necessary initially at least to reduce over-all reserves. With present inflationary trends, a reduction in over-all reserves would obviously be undesirable.

In view of prevailing unsettled conditions, any proposal for changing the method of determining bank reserves would be disturbing to the banking system at a time when the complete cooperation of the banks is necessary to the efficient functioning of the economy. The method now used to determine reserves is thoroughly familiar to the banks, and the banking system has for many years operated effectively under it. The Council therefore does not favor a change to the uniform reserve proposal at this time.

Before any steps are taken to request authority to increase maximum statutory reserve requirements, the results of the regulation of consumer credit, including more stringent consumer credit regulation, and the results of the regulation of real estate credit should be studied and evaluated. Cooperative voluntary restrictions in the extension of inflationary credit, authorized and intended by the Defense Production Act of 1950 and the President's directive of September 9, 1950, giving control over agreements for such voluntary restrictions to the Board, should be tried with the cooperation of banking and other financial associations. We recommend that prompt steps be taken by the Board to initiate and stimulate such voluntary agreements.

If economic conditions should thereafter clearly necessitate any change in maximum statutory reserve requirements, the Council is unanimously of the opinion that no special reserve in any class of government securities should be adopted, but that the pattern used in 1948 should be followed, extending temporary authority for increased maximum cash reserves, with the present division for reserve purposes of central reserve, reserve and country banks continued. Any authority granted should be for a period not to exceed two and a half years so Congress would have the right to review the matter.

2. In accordance with the discussions between Chairman McCabe and President Brown, it is understood that the Council will be prepared to discuss the reduction to two days of the maximum deferment for cash items.

The Council believes in time schedules which are actual and not artificial. Availability should be as prompt as it is possible to make it with the best transportation facilities, but it is an unsound practice to give credit for reserve purposes for an item before it is actually collected. Apart from the fundamental principle that an item should not be credited until it has reached its destination and has been collected, the proposed reduction to two days of the maximum deferment for all cash items would result in more float, and thus in more inflation at a time when efforts are being made to curb inflationary trends. The Council therefore does not favor the proposed reduction to two days of the maximum deferment for all cash items.

THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING AT 2:20 P.M. ON OCTOBER 2, 1950. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. LOCHEAD AND MR. WOODS. MR. DE WITT T. RAY SERVED AS AN ALTERNATE FOR MR. WOODS.

Dr. Woodlief Thomas introduced a number of members of the Board Staff who made a visual-verbal presentation on "The Current Economic Situation and Outlook." Copies of the discussion were distributed to members of the Council.

The meeting adjourned at 3:25 P.M.

ON OCTOBER 3, 1950, AT 10:45 A.M. THE FEDERAL ADVISORY COUNCIL HELD A JOINT MEETING WITH THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING.

ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MR. POTTS AND MR. WOODS. MR. DE WITT T. RAY SERVED AS AN ALTERNATE FOR MR. WOODS. THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MC CABE; GOVERNORS ECCLES, SZYMCZAK, EVANS, VARDAMAN, NORTON AND POWELL. MR. CARPENTER, SECRETARY OF THE BOARD OF GOVERNORS, WAS ALSO PRESENT.

WHAT FURTHER CONSIDERATION HAS BEEN GIVEN BY THE COUNCIL, OR THE SPECIAL COMMITTEE APPOINTED BY THE COUNCIL FOR THE PURPOSE, TO THE PROPOSAL TO BASE RESERVE REQUIREMENTS OF A MEMBER BANK ON THE CHARACTER OF THE BANK'S DEPOSITS RATHER THAN ON THE LOCATION OF THE BANK?

E. E. Brown reads Item 1. on the agenda and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. He states that the Council's Sub-committee of which Mr. Fleming is Chairman, arranged a meeting with representatives of the Board Staff and the livestock banks. The Board Staff was to prepare a report in connection with the discussion that took place at the meeting, particularly in relation to a possible solution for the problem which the livestock banks would face under the uniform reserve proposal. This report has not yet been received. In addition, the fact that a number of country banks would have their reserves increased would undoubtedly stir up the situation politically. Brown states that the Council may attach more significance than the Board to the idea of voluntary cooperation, but the Council believes that it is of importance. The American Bankers Association can be of help, but the restriction of credit through voluntary cooperation needs the assistance of the Investment Bankers Association, insurance companies, and others. Brown urges the Board to take action in connection with the provisions of The Defense Production Act of 1950. The Council believes that if an increase in the present maximum statutory reserves is clearly required, it would be better to have cash reserves, even if they cost more to the banks.

McCabe asks whether the Council believes the uniform reserve is correct in principle, though it may not be the right time to adopt it.

E. E. Brown. The central reserve city banks and most reserve city banks would probably favor the uniform reserve plan. Many of the country banks would undoubtedly not favor the plan. The Council itself is divided. If the plan could be worked out to satisfy the country banks and the livestock banks, it might be accepted.

McCabe. Looking at the plan objectively, without a selfish viewpoint, is it a desirable change?

Hemingway believes many banks would favor the plan, if the Board itself would look at it objectively. A number of bankers in his District feel that the Board would go to any length to get members for the System, despite any injury that might be done to the correspondent banking business.

McCabe asks whether the bankers are justified in this belief.

Hemingway. Many of them are sincere in their feeling.

Fleming. Two difficult problems were presented in the uniform reserve plan: (1) The livestock banks were dealt with unfairly; and (2) A number of country banks would have higher reserves. A committee consisting of representatives of the Board Staff and the livestock banks discussed the problem of the livestock banks, but the Staff has not submitted any report for meeting the particular problem of the livestock banks.

Beals. The purpose of the meeting of the Staff and the representatives of the livestock banks was in part to determine whether inter-bank deposits of livestock banks were different from the inter-bank deposits of other banks. The Staff said they would consider the views of the livestock banks, but they were not sure that the livestock banks had proved their case.

Fleming. Dr. Thomas said he believed, in view of the Korean situation, that this was not the time to introduce the plan, particularly because a number of country banks would oppose it.

McCabe. After the election, if Congress asks the Board's opinion of the uniform reserve plan, what does the Council believe the Board should express as its view.

Fleming. Even if the livestock bank problem is met, a reduction of reserves now to meet the objections of country banks would be unwise in view of inflationary trends.

Jackson states that E. E. Brown may be reluctant to speak, because of the position of his bank as a central reserve city bank. Jackson cannot understand why there are three classifications of banks in New York city--central reserve, reserve city and country. The gain in inter-bank deposits has not been in the central reserve city banks.

E. E. Brown believes the present basis of determining reserves is an accident historically, and it has no logic. However, the present plan has worked effectively and the banks understand it.

Powell. If many country banks are penalized, perhaps the formula needs adjustment.

Fleming. The majority of country banks would not be affected, but the minority would be very vocal.

Hemingway. If the Board feels there are inequalities in the reserves at present, the Board can adjust them.

Szymczak. The Board cannot meet the situation. One bank in a city may have correspondent bank business and another one may not have it. The Board cannot meet that problem with its present powers. We are discussing something about which we do not propose to do anything.

McCabe indicates to Szymczak that he is not sure that the Board will not do anything. McCabe states that Powell is the member of the Board responsible for this general subject.

Fleming thinks the problem has political aspects as related to country banks.

E. E. Brown asks whether the Board has started any action on voluntary cooperation under Public Law 774.

McCabe. The law has just passed. The Board believes it might start some action locally, say in Chicago, as long as E. E. Brown suggested the idea. McCabe suggests that Harold Amberg or Prochnow work with some member of the Board in carrying out the idea for voluntary cooperation.

E. E. Brown says it is impossible to start with Chicago alone, as Chicago banks compete particularly with New York, Philadelphia and Boston. He suggests that the Board work with the American Bankers Association.

McCabe asks Powell to comment on the subject of voluntary cooperation.

Powell states that the matter is nebulous in his mind. He asks just what type of loan the Council has in mind. He also asks whether Stonier is familiar with the type of loans that should be restricted.

Fleming. The Federal Reserve banks in their respective districts could form committees of commercial bankers, investment bankers and insurance men.

E. E. Brown states that committees could be set up something like the informal capital issues committees of World War I on which he served. He believes committees would be needed in each Federal Reserve District to meet once or twice a week. Perhaps a subcommittee could be formed for all Districts to lay down the rules as to the types of loans to be restricted. The difficulty is in long-term loans and not short-term loans. Some loans are clearly inflationary; some are not inflationary; and some are in a twilight zone. Brown suggests as members of the committees in the Districts, commercial bankers, investment bankers, insurance men and representatives of borrowers. The president of the Federal Reserve Bank in New York, for example, might contact the head of the clearing house in New York for suggestions as to commercial bankers to serve. In the beginning at least the restrictions would apply principally to loans of large amounts and longer maturity.

McCabe reports that the Board is going forward with its regulation of real estate credit and hopes to have Regulation X out in a matter of days. The Board is also studying the effect of Regulation W and will give it more "bite" if necessary. He points out the increase that has taken place in bank credit.

E. E. Brown. A large part of the increase in loans is in real estate loans. A number of loans are also made to department stores for carrying their accounts receivable. The reports showing the expansion of bank credit include the loans made to department stores for carrying accounts receivable, but in other places the reports show the increase in accounts receivable, so that there is some duplication in the reports. Brown states that cotton and wheat prices are higher and more money is required to carry these commodities. Cotton is moving to the mills, whereas a year ago it went into government loans.

Eccles. At that time the government borrowed so the total loans were the same.

E. E. Brown. Some of the funds of the government agency were obtained by the sale of securities.

McCabe. Aside from Regulation W, Regulation X and voluntary agreements, what can the Board do to curb bank credit?

Jackson. A large amount of credit is going to finance companies and this area could be "cooled off."

E. E. Brown also states that a large amount of the increase in bank loans represents loans to finance companies.

Lochead asks regarding the status of Regulation X.

McCabe replies that there are two principal restrictions: (1) the down payment; and (2) the maturity. He states that Norton has done a thorough job. Each group that comes in to discuss the provisions of this Regulation is asked to vote confidentially indicating what restrictions it would establish.

Norton. Mr. Foley has stated that the restrictions should be heavy. What is heavy or light is a matter of opinion. One insurance company argued for heavy restrictions and a labor group argued for light restrictions. When the Board examined the confidential votes of the two, they found that the labor group's so-called light restrictions were heavier than the insurance company's so-called heavier restrictions.

E. E. Brown. Is it fair to ask by what percentage residential building may be cut?

Norton replies that they hope to cut it from approximately $1\frac{1}{4}$ million starts this year to 800,000 or 900,000 next year. Norton reports that no one who will discuss Regulation X with the Board believes it will have any effect for five or six months, because of advance commitments in the construction field.

Eccles. What the Board and the Council are talking about is inflation--a condition of permanent pressure for inflation. The country faces a sixty to seventy-five billion dollar budget. Inflation must be stopped by a proper fiscal policy of the government. The country also needs a tight bank loan policy. The Board should stop further expansion of bank credit. Any bank loan, regardless of its purpose, whether for production or not, increases the money supply. Too much money in relation to the supply of goods makes inflation. The Board cannot do much with fiscal policies, except to advise. What the Board can do is to control bank credit. Eccles has very little hope for the voluntary method among 15,000 banks. The uniform reserve method is good housekeeping and it is more equitable, but it does not meet the problem. You may eliminate the central reserve city classification and call the large cities all reserve cities, but you will never get all of the banks on the same basis. The only way you can meet the problem is by more reserves. The special reserve is one plan. It provides a special demand for short-term paper at a special rate. It does not affect the rediscount rate. Wiggins' position puts the Federal Reserve System at the will of the Treasury. The Federal Reserve System must support the government program, and so the result of Wiggins' idea is that the Fed would pump reserves into the System. If the Federal Reserve System must support government bonds with the rates pegged, it places the Federal Reserve System in the position of increasing reserves in a very inflationary situation.

E. E. Brown. The special reserve increases reserves even if you have two rates.

Eccles. With special reserves there must be increased taxes.

E. E. Brown. You also have wage increases to consider.

Eccles. Wage increases must also stop if you are to curb inflation. It is difficult to say whether price increases or wage increases come first. It is necessary to have a sound fiscal policy and a sound Federal Reserve or monetary policy. If we do not stop inflation, we are going into a garrison state with all types of controls, as this is a permanent inflationary situation. We are only kidding ourselves, if we fail to stop bank credit expansion, and we face the loss of democratic capitalism.

Fleming. Has any study been made as to the effect of excess profits?

Eccles states that he does not know what kind of excess profits tax there will be.

Jackson. If you stop bank loans, do you not stop production, and thus injure the economy.

Eccles. We know that the supply of money is excessive with a normal velocity. With greater velocity it would be even worse. Bank credit should not increase with prices, but with production. Bank credit has gone up faster than production.

J. T. Brown. The government has released cotton and Southern bankers have had to increase their loans to take up the cotton.

Eccles. As Southern bankers increase their loans the Commodity Credit Corporation gets money to pay off its obligations, so that over the entire country the total credit should not increase.

Bucklin believes that the Board has an important new instrument in the new law providing for voluntary agreements. He does not believe that the only way to curb inflation is to raise reserves. He believes the banks want to control credit even though there are 15,000 banks. With this new instrument the Board can take the initiative to get large banks to restrict large loans.

E. E. Brown thinks the Board should work with the American Bankers Association on the matter of voluntary agreements.

Congdon states that there are three types of credit that need control: (1) loans to ultimate consumers; (2) loans for productive purposes that are not essential; (3) loans to build up excessive inventories. Regulation W should cover number one. Voluntary cooperation through committees should reach number two, and number three can be reached by a program of the American Bankers Association.

Eccles. Is the Department of Commerce controlling inventory?

McCabe is alarmed over the possibility of such inventory control, as it may lead to control of the complete economy. Washington is in an emotional state and could head to complete control.

Fleming. What would the attitude of the public be if banks were required to hold government bonds.

Szymczak. The law does not state they must hold government bonds.

Fleming. The special reserve would provide for it.

Eccles. Under the special reserve a bank could keep either cash or short-term governments.

Fleming. There does not seem to be genuine enthusiasm by the Board for the idea of voluntary cooperation.

E. E. Brown believes the matter must be discussed with the American Bankers Association.

Vardaman. There have been two examples of cooperation. There was the American Bankers Association plan and the Broderick plan on mortgage financing in New York state. The latter plan was so satisfactory that all those who took part were indicted. This would not occur under the present law.

Evans wishes to know what the Council's views are on tightening Regulation W. The terms as announced are tighter than the American Bankers Association committee recommended.

Eccles. The public is rapidly losing confidence in the dollar. Dis-savings is going on. If the inflationary trend isn't hit hard now, it can develop to dangerous proportions. If the people go out of dollars into goods, we shall have trouble. There are even some persons who say that if the banks tighten credit terms to require bigger down payments, the people will take more money out of their savings accounts to make the down payments. Consequently, savings would fall.

Hemingway asks why the Board doesn't announce tighter terms, if the objective is sharply to restrict consumer credit.

McCabe. The Board tightened the terms even more than the bankers and finance companies wanted.

Fleming is inclined to favor cutting the terms to fifteen months rather than to eighteen months. If the Board reduces the terms to eighteen months, the public may buy more in anticipation of a tightening of the terms to fifteen months.

E. E. Brown. If Eccles is correct, the Board should go to fifteen months.

Evans. Eighty per cent of the automobile sales prior to the Regulation were on more favorable terms than the Regulation W terms which were announced.

McCabe. If the Board tightens terms further, everyone will be down to Washington complaining, the automobile dealers, the Congressmen and everyone else.

IN ACCORDANCE WITH THE DISCUSSIONS BETWEEN CHAIRMAN MC CABE AND PRESIDENT BROWN, IT IS UNDERSTOOD THAT THE COUNCIL WILL BE PREPARED TO DISCUSS THE REDUCTION TO TWO DAYS OF THE MAXIMUM DEFERMENT FOR CASH ITEMS.

E. E. Brown reads Item II on the Agenda. It is nonsense to say a bank in Maine could collect an item in Arizona in two days. At a time when the Board speaks about increasing reserves it is illogical to take a step that adds to float and thus to the inflationary trend.

McCabe asks Powell to comment, as Powell made the report to the meeting of the presidents of the Federal Reserve banks dealing with this subject.

Powell. The Federal Reserve banks have gradually reduced their time schedules. Figures taken off in the summer of 1949 indicate that changing from three to two days would only add $130 million daily to the float. Ever since 1916 there have been inequalities between Districts. Boston, New York and Philadelphia have a two day deferment between their Districts. Recently some other Federal Reserve banks have gone to a two day deferment, either within the district, or within an area in the district. There are three benefits of a two day deferment: (1) it eliminates inequalities now existing between banks; (2) it reduces the sorting problem of banks; (3) it reduces the clerical work of the Federal Reserve banks. There were 4,643 banks in 1949 that did not send any deferred items to the Federal Reserve Banks.

E. E. Brown agrees that the adoption of this idea will not upset the national economy, but he still believes the idea is unsound. He does not agree that $130 million is insignificant. If the idea of giving credit before it is due is finally accepted, the banking system is accepting an unsound idea.

Ringland states that the efforts of the Federal Reserve System to cut down time schedules in relation to improved transportation is appreciated. However, by giving credit to an item before it is due, treasurers of national companies will be induced to withdraw funds not actually collected. These treasurers have very sharp pencils.

Powell thinks the Open Market Committee would use the funds if the treasurers didn't.

Ringland believes the treasurers would get there first.

Congdon. This is apparently only a step to immediate availability.

Eccles states that $130 million is small in relation to the total volume of business.

J. T. Brown states that the principle of adding $130 million daily to the inflationary forces is bad at a time when the Board wishes to make efforts to combat inflation.

Eccles believes the country banks would favor it, but the Council represents largely central reserve and reserve city banks. The Council naturally opposes it, because the members of the Council have correspondent bank balances. Eccles states that he must look at it from the general public good. When and if he becomes a private banker, he will probably look at it from the standpoint of the private banks.

Fleming asks whether the Board wishes the Council to contact the American Bankers Association on voluntary cooperation.

McCabe suggests that the Council, through Fleming, contact the American Bankers Association regarding the matter of voluntary cooperation among banks.

Fleming wishes the Board could have the presidents of the Federal Reserve banks, representatives of the American Bankers Association, and the proper government officals present at a meeting so all would be informed.

The meeting adjourned at 1:32 P.M.

The next meeting of the Council will be held November 19, 20 and 21, 1950.

THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING AT 2:40 P.M. ON OCTOBER 3. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. POTTS, JACKSON AND WOODS. MR. DE WITT T. RAY SERVED AS AN ALTERNATE FOR MR. WOODS.

The members of the Council discussed informally the best method of making the agreements for voluntary cooperation effective. The opinion was expressed that it would be impossible to set up committees over the entire country that would determine whether every loan of every type--short or long term-- was inflationary. It was felt that there were two ideas which would be practical. One idea was to set up regional or capital issues committees in the larger cities dealing with larger loans of longer maturity. The other suggestion was that the American Bankers Association work out a general program urging banks to restrict credit to essential purposes.

It was agreed that Fleming and Hemingway would talk with Stonier regarding the subject of voluntary cooperation, and E. E. Brown would discuss the matter with James E. Shelton, by telephone.

The meeting adjourned at 3:25 P.M.