

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

May 15, 1955

The second statutory meeting of the Federal Advisory Council for 1955 was convened in Room 932 of the Mayflower Hotel, Washington, D.C., on May 15, 1955, at 2:10 P.M., the President, Mr. Brown, in the Chair.

Present:

William D. Ireland	District No. 1
Henry C. Alexander	District No. 2
William R. K. Mitchell	District No. 3
Frank R. Denton	District No. 4
Robert V. Fleming	District No. 5
Wallace M. Davis	District No. 6
Edward E. Brown	District No. 7
W. W. Campbell	District No. 8
Joseph F. Ringland	District No. 9
Charles J. Chandler	District No. 10
George G. Matkin	District No. 11
John M. Wallace	District No. 12
Herbert V. Prochnow	Secretary

On motion duly made and seconded, the mimeographed notes of the meeting held on February 13, 14, 15, 1955, copies of which had been sent previously to the members of the Council, were approved.

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 15, 16 and 17.

The meeting adjourned at 5:35 P.M.

HERBERT V. PROCHNOW
Secretary

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

May 16, 1955

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

Present: Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, William R. K. Mitchell, Frank R. Denton, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, and Herbert V. Prochnow, Secretary.

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* which follows on pages 15, 16 and 17, listing the agenda items with the conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 12:15 P.M. on May 16, 1955.

The meeting adjourned at 12 noon.

HERBERT V. PROCHNOW
Secretary

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL
ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR THE
JOINT MEETING ON MAY 17, 1955

1. Consideration of the salaries of the Chairman and the members of the Board of Governors of the Federal Reserve System.

The members of the Council have on various occasions expressed themselves in favor of increasing the salaries of the Chairman and the members of the Board of Governors of the Federal Reserve System. The Council again strongly urges that favorable consideration be given to this matter and has unanimously approved the following resolution:

With the establishment of the Federal Reserve System in 1913, the Congress specified salaries for members of the Board which were equivalent to those of Cabinet members and in excess of those of members of the Congress. For a number of years that relationship prevailed. At the present time the salaries of members of the Board are materially below those of Cabinet officers and also below those of members of the Congress as well as of other government officials of less or no greater responsibility.

The Board of Governors has responsibilities of far-reaching importance to the nation's economy. The salaries of the members of the Board should more adequately reflect these responsibilities and should be made more attractive to persons with the highest qualifications.

An increase in the salaries of the members of the Board would also justify a much-needed revision upward in the salaries of the members of the staff in order to retain and attract persons of high competence.

The Council believes that legislation should be passed providing that the salary of the Chairman of the Board, who is its active executive officer, should be \$22,500 annually, and that salaries of the members of the Board should be at least \$20,000 annually.

2. H. R. 2643, introduced by Representative Patman on January 20, 1955, "To direct the Comptroller General to audit the Board of Governors of the Federal Reserve System, the Federal Open Market Committee, and the Federal Reserve banks."

The attention of the Council has been called to H. R. 2643, a bill "to direct the Comptroller General to audit the Board of Governors of the Federal Reserve System, the Federal Open Market Committee, and the Federal Reserve banks." The members of the Council are unanimously of the opinion that the auditing procedures suggested in H. R. 2643 are unnecessary, unwise, and contrary to the fundamental concept of the independence of the Federal Reserve System. The Council believes that the examination and auditing procedures of the Federal Reserve System should be set by the Federal Reserve Board. The Council has therefore authorized its officers to testify in opposition to the bill if it should come up for hearings in the Congress.

3. The Board would like to have the comments of the members of the Council on the business and economic outlook throughout the spring and summer of the current year, and it would appreciate having the Council's views as to the probable demand for bank loans in that period compared with demand during the corresponding period of 1954.

Members of the Council report that business activity in general is at a high level in all twelve districts but with some variations from industry to industry and with some industries lagging behind. Consumer spending and construction are setting new records. In all twelve districts, the over-all economic outlook for the spring and summer months is good, and business sentiment is favorable, as reflected in plans for large expenditures for the expansion of plant and equipment.

Agriculture, with a decline in the prices of farm products and farm income, is an important exception to the broad upward trend in the economy. The outlook for farmers has also been adversely affected over wide areas by drought and freezes.

All members of the Council anticipate that there will be an increasing demand for loans in the months immediately ahead, and that the total volume of loans will be larger than in the corresponding period a year ago.

4. In addition to the views of the Council on the general business situation, the Board would be interested in having the Council's views as to the effects of System credit policies since the last meeting of the Council and whether these policies should be changed in any way in the light of the business and economic situation during the near term.

The effects of System credit policies since the last meeting of the Council have been good. The Council believes that a policy of mild credit restriction should be continued for the near term if business continues to be buoyant.

Government financing for new money in substantial volume is inevitable in the last half of the calendar year. If, as seems probable, the banks must provide a considerable part of the new money required, and if business continues at a high level with an increasing demand for bank loans, the System must be prepared through open market operations or a reduction in reserve requirements, or both, to put more reserves into the banks. In view of the increasing activity of business and of the probability of an increase in loans in the months immediately ahead, it may become necessary to consider raising the rediscount rate. The use of the discount window by member banks should not be restricted or discouraged, as credit for good borrowers should continue to be available at reasonable rates.

5. The Board would appreciate receiving the Council's views as to whether a change in the substitution rule under Regulations T and U, to require that proceeds of sales in under-margined accounts be applied to reduce the debit balance, would be desirable or undesirable.

The Council is unanimously of the opinion that it would be undesirable at present to change the substitution rule under Regulations T and U.

6. The present policy of the Board is to make a determination with respect to whether there is a payment of interest on demand deposits under Regulation Q only after development of all pertinent facts through an examination. The Board would appreciate having the Council's views as to whether various practices being followed by banks result in a substantial noncompliance with the intent of the law or the regulation, and what, if any, changes in Board policy or in the law might be desirable?

The Council believes that member banks generally seek to and do obey the intention of Regulation Q. As the Board memorandum states, "there appears to be no completely satisfactory way of handling questions as to what constitutes an indirect payment of interest" against the intent of the law.

Of the possible alternatives which the Board has presented in its memorandum, the Council favors Paragraph (2), page 5 of the memorandum, with an amendment in the language to read as follows:

The Board should adopt a policy to the effect that the legal prohibition against indirect payments of interest is "self-policing", that each member bank, therefore, has the responsibility of determining whether its practices conform to the law; but that the Board, through bank examinations, will be alert to obvious violations and in such cases take steps to enforce the law.

The Council believes it is unwise to publish the Board's findings in individual cases, or to publish in detail practices the Board considers contrary to the intent of the law. Factual situations are almost never completely identical. Such publication would cause confusion in the minds of bankers and increase the difficulties of administration.

The Council does not believe any change in the law affecting member banks is desirable.

MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

May 16, 1955

At 2:15 P.M., the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D.C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, William R. K. Mitchell, Frank R. Denton, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, and Herbert V. Prochnow, Secretary.

Dr. Woodlief Thomas, Economic Advisor to the Board, and Dr. Ralph A. Young, Director of the Division of Research and Statistics, with other members of the staff, gave an audio-visual presentation on "From Recovery to Expansion". The presentation was off-the-record.

The meeting adjourned at 3:50 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

May 17, 1955

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 Wm. McC. Martin, Jr.; Governors M. S. Szymczak, James K. Vardaman, Jr., A. L. Mills, Jr., J. L. Robertson, Chas. N. Shepardson, and C. Canby Balderston; also Mr. S. R. Carpenter, Secretary, and Mr. Merritt Sherman, Assistant Secretary of the Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, William R. K. Mitchell, Frank R. Denton, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, and Herbert V. Prochnow, Secretary.

The President of the Council read the first item of 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 15, 16 and 17.

The President of the Council read the second item on the agenda and the conclusions of the Council as given in the *Confidential Memorandum* mentioned above.

President Brown then read the third item on the agenda and the conclusions of the Council as stated in the *Confidential Memorandum* previously mentioned. An extended discussion followed.

President Brown read the fourth item on the agenda and the conclusions of the Council as given in the *Confidential Memorandum* cited above. President Brown added that the use of the discount window should not be restricted or discouraged.

A discussion followed in which members of the Board and the Council participated.

The President of the Council read the fifth item on the agenda and the conclusions of the Council as stated in the *Confidential Memorandum* previously mentioned.

The sixth item on the agenda and the conclusions of the Council as stated in the *Confidential Memorandum* previously mentioned were read by President Brown. A brief discussion followed.

The meeting adjourned at 12:55 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 at the end of the year.

The Secretary's notes of the meeting of the Federal Advisory Council on May 15, 1955, at 2:10 P. M. in Room 932 of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present.

The Council approved the Secretary's notes for the meeting of the Council on February 13, 14 and 15, 1955.

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ITEM I

CONSIDERATION OF THE SALARIES OF THE CHAIRMAN AND THE MEMBERS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

Brown asked Fleming to comment on this item.

Fleming. The Council has previously expressed itself in favor of higher salaries for the Board of Governors. The American Bankers Association has recently taken steps to help realize this objective. Fleming believes it might be helpful if the Council also went on record again for higher salaries for members of the Board. The Comptroller's office, the FDIC office, and the Federal Reserve System are not supported by the taxpayers. Various proposals have been made regarding the salaries which should be paid to members of the Board. The following are among the proposals which have been made regarding the salaries of the Board of Governors:

Chairman	\$22,500
Other Board Members	20,000
Chairman	22,500
Other Board Members	22,000
All Board Members, including Chairman	22,500

Brown suggests that the Chairman of the Board of Governors should receive a salary equal to that of a Cabinet member, which is \$22,500, and other Board members should receive at least \$20,000. The Council's resolution might say that when the System was established, the salaries were equal to those of Cabinet members. Since then the salaries of Cabinet members have advanced, and the salaries of members of the Board are now materially below those of Cabinet officers.

ITEM II

H. R. 2643 INTRODUCED BY REPRESENTATIVE PATMAN ON JANUARY 20, 1955, "TO DIRECT THE COMPTROLLER GENERAL TO AUDIT THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL OPEN MARKET COMMITTEE, AND THE FEDERAL RESERVE BANKS."

Fleming. (Off-the-record comments).

Davis. (Off-the-record comments).

Brown. (Off-the-record comments). The Council may state that its attention has been called to H. R. 2643 and the Council is of the opinion that the auditing procedures suggested in H. R. 2643 are unnecessary, unwise and contrary to the fundamental concepts of the operation of the Federal Reserve System. The Council believes that the examination and auditing procedures now established in the Federal Reserve System are adequate. The Council has, therefore, authorized its officers to testify in opposition to the bill if it should come up for hearings. (A motion was made, seconded and approved unanimously by the Council in support of the views Brown had expressed).

ITEM III

THE BOARD WOULD LIKE TO HAVE THE COMMENTS OF THE MEMBERS OF THE COUNCIL ON THE BUSINESS AND ECONOMIC OUTLOOK THROUGHOUT THE SPRING AND SUMMER OF THE CURRENT YEAR, AND IT WOULD APPRECIATE HAVING THE COUNCIL'S VIEWS AS TO THE PROBABLE DEMAND FOR BANK LOANS IN THAT PERIOD COMPARED WITH DEMAND DURING THE CORRESPONDING PERIOD OF 1954.

Ireland reports that the business outlook in his district is good. The textile industry is having a somewhat better volume. Production in the boot and shoe industry is high. Bank loans are up over a year ago. Ireland looks forward to a continuance of good business and to some increase in bank loans. Mortgage money is plentiful. Although business is good, the margin of profit may be narrowing. The Federal Reserve Bank of Boston has urged banks not to liberalize installment credit terms.

Alexander. The second district has been recording gains, but they are not as great as the gains for the country as a whole. Construction is up, but it has not increased as much as it has for the entire country. There have been some layoffs in defense industries. Activity in the radio and television industry is relatively low. The automobile, steel and primary metal industries are very buoyant. The textile industry is a little better than it has been. Farm income is about 4 per cent below a year ago. Economic recovery is in progress but not as great as the country generally is experiencing. The demand for commercial loans will probably be greater than for the corresponding period a year ago.

Mitchell. Business is expanding, but not as much as over the rest of the country. Textiles and coal are a little better. The automobile industry and housing are at high levels. Employment is improving, but it is still not good in some areas. Business men, generally, are optimistic. Bank loans are higher, and Mitchell expects them to increase.

Denton. Business currently is very good. Business and industrial loans are still a little below a year ago, although at that time they were declining. The present upward trend in loans is due in considerable part to increases in consumer and real estate loans. Total commercial loans, plus consumer and real estate loans, are expected to show an upward trend. The agricultural industry is experiencing a downtrend. The coal industry is a little better than it has been.

Davis. The economists report that business in the district is good. The housing industry is strong; department store sales are excellent; business generally is at a high level. However, the effects of last summer's drought are now becoming evident. In addition, there have been freezes. In some ways, we appear to be entering a period like the late 1920's, when we had profitless prosperity. Loans are up over a year ago, and the demand for loans probably will increase.

Brown. Business is extremely good. Except for the dairy industry, the agricultural industry is not especially bad. The steel industry is operating at capacity. Private and public construction are both at high levels. Large industrial concerns are planning expansion. Such projects once begun, must be completed. The increasing demand for credit has come largely from various concerns seeking term financing, finance companies, large department stores and mail order concerns which need more money to carry receivables, and the contractors seeking funds for construction. Other than these demands for credit, the demand for commercial loans is not particularly large. It now appears that the total volume of loans will increase. The large concerns are, with some exceptions, making better profits than a year ago.

Campbell. Business is operating at a high level, especially in the metropolitan areas. Department store sales in the large cities are good, but retail sales in the rural areas are not so good. The farm outlook is not so bright, because of reduced acreage. With good weather and good yields, the farmer will make a small profit, but with poor weather and poor crops, the farmer will not do so well. Farm loans and consumer credit have increased. Demand deposits are holding their own. Campbell expects some increase in loans.

Ringland states that business in his district is about as that described in the seventh district. His district could use moisture in the agricultural area but the situation is not desperate. The outlook for shipments of iron ore is good. An active demand exists for loans. Agricultural income is off, and the dairy areas are dissatisfied. Ringland expects a rising demand for loans.

Chandler. The situation in his district is similar to that of the rest of the country. Department store sales are up 10 per cent over a year ago. The construction industry is good. The oil industry is somewhat better than it has been. However, it now appears that the winter wheat crop will only be about 50 per cent of the normal crop and that the yield in Texas will be even lower. The winter wheat crop is much lighter. The rains have been spotty. Loans are increasing and Chandler expects total loans to rise further, although farm loans may be down. The demand for consumer credit is likely to be strong. The outlook for business generally is good.

Matkin reports that conditions in his district follow the national trends, which have been described by other members of the Council. Almost any kind of new car now can be bought on used car lots. Moisture is

fair in about one-third of the district and poor in two-thirds of the district. Business generally is very good. Credit demands at commercial banks are increasing and Matkin expects an expansion in total bank loans.

Wallace. General business in his district is well above the national average. Retail trade is above a year ago. Housing starts are higher than the national average. Loans are above a year ago and Wallace expects the volume of loans to increase. A new gas line from the Pacific Northwest and other similar developments will probably greatly stimulate further industrial growth in the district. Some areas are beginning to suffer from the drought. Wallace understands that after 1975 more power plants will be uranium fueled than otherwise. Business for the balance of the year is likely to be above the national average.

Fleming reports that business in his district is generally good. One weak spot is the lower cash income for agriculture. There is a stronger demand for coal; auto sales are very good. Consumer durables account for most of the strength in business. Loans are sharply higher than a year ago. The lumber and furniture industries are doing better, and department store sales are higher.

Brown. The Council may state that the outlook for business through the spring and summer of the current year looks very good in all the districts. The one major segment which is not sharing in the broad upward trend is agriculture. In some areas, the outlook for farmers has been adversely affected by drought and freezes. All twelve districts expect an increasing demand for loans in the spring and summer.

ITEM IV

IN ADDITION TO THE VIEWS OF THE COUNCIL ON THE GENERAL BUSINESS SITUATION, THE BOARD WOULD BE INTERESTED IN HAVING THE COUNCIL'S VIEWS AS TO THE EFFECTS OF SYSTEM CREDIT POLICIES SINCE THE LAST MEETING OF THE COUNCIL AND WHETHER THESE POLICIES SHOULD BE CHANGED IN ANY WAY IN THE LIGHT OF THE BUSINESS AND ECONOMIC SITUATION DURING THE NEAR TERM.

Fleming outlines the possible requirements of the Treasury for the last half of the year. The present confidential estimates are that the Treasury may require \$10½ billion of new money in the last half of the calendar year. The Treasury may try to obtain about \$4 billion in July and August and the other \$6½ billion from September through December. Fleming believes that the actions of the Board in raising margin requirements and the rediscount rate were good.

Alexander believes that System credit policies since the last meeting have been good, and he believes a policy of mild credit restraint should be continued.

Brown asks for the views of the Council, and all members agree that the System's credit policies since the last meeting of the Council have been good, and that a policy of mild restraint should be continued. The policy has been one of slight restriction. No such stringency as existed in the early part of 1953 now exists. The Treasury will need considerably more new money. More reserves will be required in the future and they may be obtained either by open market operations, or by a

reduction in reserve requirements, or both. If, as seems probable, the banks will be called upon to provide a considerable part of the new money, and if business continues at a high level, with an increasing demand for bank credit, the System must be prepared, either through a reduction in reserve requirements or by open market operations, or both, to put more reserves into the banks. Brown points out that there apparently has been a change in the view of some persons in the System who now favor more use of the discount window. If the present business buoyancy continues, and the demand for loan increases, it may become necessary to consider raising the rediscount rate. The banks should not be discouraged from using the discount window.

Alexander. Credit should be available to good borrowers, even at higher rates.

Brown agrees that credit for good borrowers should be available at present rates, or, if necessary, at higher rates.

ITEM V

THE BOARD WOULD APPRECIATE RECEIVING THE COUNCIL'S VIEWS AS TO WHETHER A CHANGE IN THE SUBSTITUTION RULE UNDER REGULATIONS T AND U, TO REQUIRE THAT PROCEEDS OF SALES IN UNDER-MARGINED ACCOUNTS BE APPLIED TO REDUCE THE DEBIT BALANCE, WOULD BE DESIRABLE OR UNDESIRABLE.

Mitchell states that he does not like this idea.

Brown thinks a change now would be confusing.

Alexander believes that any measure which forces liquidation is apt to be bad.

Ireland. If and when a margin requirement increase is necessary, could not this procedure be used in its place?

Brown. This procedure would greatly decrease activity in the market.

Denton doubts the wisdom of taking this action now.

Brown. The continued uninterrupted rise in the market is the bad feature in the market.

Ireland. With current yields on investment trusts where they are now, they look much less attractive.

Brown. The Council may state that it is opposed at this time to this change in Regulations T and U.

ITEM VI

THE PRESENT POLICY OF THE BOARD IS TO MAKE A DETERMINATION WITH RESPECT TO WHETHER THERE IS A PAYMENT OF INTEREST ON DEMAND DEPOSITS UNDER REGULATION Q ONLY AFTER DEVELOPMENT OF ALL PERTINENT FACTS THROUGH AN EXAMINATION. THE BOARD WOULD APPRECIATE HAVING

THE COUNCIL'S VIEWS AS TO WHETHER VARIOUS PRACTICES BEING FOLLOWED BY BANKS RESULT IN A SUBSTANTIAL NONCOMPLIANCE WITH THE INTENT OF THE LAW OR THE REGULATIONS, AND WHAT, IF ANY, CHANGES IN BOARD POLICY OR IN THE LAW MIGHT BE DESIRABLE?

Brown states that when a bank pays checks against an account it renders a service and is indirectly paying interest. If you prohibited interest, directly or indirectly, you would require a service charge on every account, and that would end the banking business.

Ringland believes that the substance of the Staff memorandum is in the last few lines dealing with the absorption of exchange charges.

Davis cites cases of abuses in relation to indirect interest payments. However, he believes that in the main the banks are obeying the intention of Regulation Q. He would dislike to see this question become one for public discussion. The Council need not deny that there are some practices subject to criticism. He would like to have the Council adopt paragraph (2) on page 5 of the Staff memorandum.

Ringland. (Off-the-record comments).

Brown cites situations in Indiana, Michigan and Ohio where a tax is absorbed by banks. If the banks did not absorb the tax, they would lose their deposits.

Davis. There is a limit in what can be done in absorbing charges.

Campbell believes as Wallace Davis does that there is a limit to the absorption of charges.

Ringland cannot understand the views of the F. D. I. C. on the absorption of exchange charges. He understands they use the word "reasonable" in connection with the limit of such charges.

Mitchell reports that the views among the bankers in his district vary widely.

Brown believes the question should not be opened up for wide discussion. Brown favors paragraph(2) on page 5 of the Staff memorandum. He does not believe the rulings should be published. (At this point various members of the Council gave illustrations of practices similar to those outlined in the Staff memorandum.)

Matkin recommends that the Board continue its efforts to get the F.D.I.C. to conform to the view that the absorption of exchange charges is a payment of interest.

Fleming does not favor publishing the findings of the Board.

Brown would agree with Matkin's suggestion.

Fleming. In the absence of an accord between the Board, the F.D.I.C. and the Comptroller, Fleming thinks the examiners should report in their examinations cases where there are violations. He thinks the Board should continue its efforts to get the F.D.I.C. to conform to the Board's views.

Brown suggests that the Council should state that it is in accord with paragraph(2) on page 5 of the Staff memorandum except that the paragraph should begin, "The Board should adopt a policy to the effect that,".

Brown will state verbally at the meeting with the Board that the Council hopes the Board will continue its efforts to synchronize the views of the three agencies. The Council also believes it would be unwise to publish the Board's findings in individual cases.

The meeting adjourned at 5:35 P.M.

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THE FEDERAL ADVISORY COUNCIL CONVENED AT 10 A.M. ON MAY 16, 1955, IN ROOM 932 OF THE MAYFLOWER HOTEL, WASHINGTON, D. C. ALL MEMBERS OF THE COUNCIL WERE PRESENT.

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 May 17, 1954. The Memorandum was delivered to Mr. Carpenter, Secretary of the Board of Governors at 12:15 P.M. on May 16, 1955. It will be noted that each item of the Agenda is listed together with the comments of the Council.

The meeting adjourned at 12 noon.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON MAY 17, 1955

1. Consideration of the salaries of the Chairman and the members of the Board of Governors of the Federal Reserve System.

The members of the Council have on various occasions expressed themselves in favor of increasing the salaries of the Chairman and the members of the Board of Governors of the Federal Reserve System. The Council again strongly urges that favorable consideration be given to this matter and has unanimously approved the following resolution:

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The Board of Governors has responsibilities of far-reaching importance to the nation's economy. The salaries of the members of the Board should more adequately reflect these responsibilities and should be made more attractive to persons with the highest qualifications.

An increase in the salaries of the members of the Board would also justify a much-needed revision upward in the salaries of the members of the staff in order to retain and attract persons of high competence.

The Council believes that legislation should be passed providing that the salary of the Chairman of the Board, who is its active executive officer, should be \$22,500 annually, and that salaries of the members of the Board should be at least \$20,000 annually.

2. H. R. 2643, introduced by Representative Patman on January 20, 1955, "To direct the Comptroller General to audit the Board of Governors of the Federal Reserve System, the Federal Open Market Committee, and the Federal Reserve banks."

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3. The Board would like to have the comments of the members of the Council on the business and economic outlook throughout the spring and summer of the current year, and it would appreciate having the Council's views as to the probable demand for bank loans in that period compared with demand during the corresponding period of 1954.

Members of the Council report that business activity in general is at a high level in all twelve districts but with some variations from industry to industry and with some industries lagging behind. Consumer spending and construction are setting new records. In all twelve districts, the over-all economic outlook for the spring and summer months is good, and business sentiment is favorable, as reflected in plans for large expenditures for the expansion of plant and equipment.

Agriculture, with a decline in the prices of farm products and farm income, is an important exception to the broad upward trend in the economy. The outlook for farmers has also been adversely affected over wide areas by drought and freezes.

All members of the Council anticipate that there will be an increasing demand for loans in the months immediately ahead, and that the total volume of loans will be larger than in the corresponding period a year ago.

4. In addition to the views of the Council on the general business situation, the Board would be interested in having the Council's views as to the effects of System credit policies since the last meeting of the Council and whether these policies should be changed in any way in the light of the business and economic situation during the near term.

The effects of System credit policies since the last meeting of the Council have been good. The Council believes that a policy of mild credit restriction should be continued for the near term if business continues to be buoyant.

Government financing for new money in substantial volume is

inevitable in the last half of the calendar year. If, as seems probable, the banks must provide a considerable part of the new money required, and if business continues at a high level with an increasing demand for bank loans, the System must be prepared through open market operations or a reduction in reserve requirements, or both, to put more reserves into the banks. In view of the increasing activity of business and of the probability of an increase in loans in the months immediately ahead, it may become necessary to consider raising the rediscount rate. The use of the discount window by member banks should not be restricted or discouraged, as credit for good borrowers should continue to be available at reasonable rates.

5. The Board would appreciate receiving the Council's views as to whether a change in the substitution rule under Regulations T and U, to require that proceeds of sales in under-margined accounts be applied to reduce the debit balance, would be desirable or undesirable.

The Council is unanimously of the opinion that it would be undesirable at present to change the substitution rule under Regulations T and U.

6. The present policy of the Board is to make a determination with respect to whether there is a payment of interest on demand deposits under Regulation Q only after development of all pertinent facts through an examination. The Board would appreciate having the Council's views as to whether various practices being followed by banks result in a substantial noncompliance with the intent of the law or the regulation, and what, if any, changes in Board policy or in the law might be desirable?

The Council believes that member banks generally seek to and do obey the intention of Regulation Q. As the Board memorandum states, "there appears to be no completely satisfactory way of handling questions as to what constitutes an indirect payment of interest" against the intent of the law.

Of the possible alternatives which the Board has presented in its memorandum, the Council favors Paragraph (2), page 5 of the memorandum, with an amendment in the language to read as follows:

The Board should adopt a policy to the effect that the legal prohibition against indirect payments of interest is "self-policing"; that each member bank, therefore, has the responsibility of determining whether its practices conform to the law; but that the Board, through bank examinations, will be alert to obvious violations and in such cases take steps to enforce the law.

The Council believes it is unwise to publish the Board's findings in individual cases, or to publish in detail practices the Board considers

contrary to the intent of the law. Factual situations are almost never completely identical. Such publication would cause confusion in the minds of bankers and increase the difficulties of administration.

The Council does not believe any change in the law affecting member banks is desirable.

THE FEDERAL ADVISORY COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D. C. AT 2:15 P.M. ON MAY 16, 1955. ALL MEMBERS OF THE COUNCIL WERE PRESENT.

Dr. Woodlief Thomas, Economic Adviser to the Board, and Dr. Ralph A. Young, Director, Division of Research and Statistics of the Board of Governors of the Federal Reserve System, with other members of the staff, gave an audio-visual presentation on "From Recovery to Expansion". The presentation was off-the-record.

The meeting adjourned at 3:50 P.M.

ON MAY 17, 1955, 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, WASHINGTON, D.C.

ALL MEMBERS OF THE COUNCIL WERE PRESENT. THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, GOVERNORS SZYMCAK, VARDAMAN, ROBERTSON, MILLS, BALDERSTON AND SHEPARDSON. MR. CARPENTER, SECRETARY, AND MR. SHERMAN, ASSISTANT SECRETARY OF THE BOARD OF GOVERNORS, WERE ALSO PRESENT.

ITEM I

CONSIDERATION OF THE SALARIES OF THE CHAIRMAN AND THE MEMBERS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

Brown reads Item I and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. He states that the American Bankers Association has also expressed itself favorably on this matter. The Council passed the resolution which Brown read so that if the bill comes up for hearings, officers of the Council can testify in favor of it.

Fleming believes that the chances are good for a bill to be introduced, but it is largely a matter of proper timing.

Martin states that he cannot add anything to the discussion. He believes that there is a chance for a bill to be introduced. He has been working for four years to have the salaries of the members of the Board increased.

ITEM II

H. R. 2643 INTRODUCED BY REPRESENTATIVE PATMAN ON JANUARY 20, 1955, "TO DIRECT THE COMPTROLLER GENERAL TO AUDIT THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL OPEN MARKET COMMITTEE, AND THE FEDERAL RESERVE BANKS".

Brown reads Item II and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. The purpose of the Council's action is to permit the officers of the Council to testify in opposition to the bill if it should come up for hearings in the Congress.

Martin. No date has been set for hearings. The matter is in the hands of the Committee on Government Operations. Robert H. Mollohan of West Virginia is Chairman of the Sub-committee handling this matter.

ITEM III

THE BOARD WOULD LIKE TO HAVE THE COMMENTS OF THE MEMBERS OF THE COUNCIL ON THE BUSINESS AND ECONOMIC OUTLOOK THROUGHOUT THE SPRING AND SUMMER OF THE CURRENT YEAR, AND IT WOULD APPRECIATE HAVING THE COUNCIL'S VIEWS AS TO THE PROBABLE DEMAND FOR BANK LOANS IN THAT PERIOD COMPARED WITH DEMAND DURING THE CORRESPONDING PERIOD OF 1954.

Brown reads Item III and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. In the past there generally have been one or two districts where conditions differed materially from other districts. While there are still some differences in economic conditions in the various districts, general business in all the districts is good. Some small businesses are not sharing fully in the upward trend. Agriculture is experiencing lower prices and lower income. Industry is planning large expenditures for the expansion of plant and equipment. Although it seems inevitable that a downturn will come sooner or later in residential construction, at present there are no serious signs of a major downturn in such construction. The drought in some areas has been severe and the effects of last year's drought are being felt in retail sales in farm areas. The over-all prospects are for the continuation of good business. In all twelve districts an increasing demand for loans is anticipated, especially for consumer credit, loans to finance companies, and loans for construction.

Fleming believes the Staff report to the Council yesterday tends to confirm the views the Council expressed in its Memorandum.

Martin asks whether employment is lagging and also whether inventories are accumulating.

Denton. In his district there are definite areas of unemployment. Certain groups are not sharing in the prosperity. Smaller foundries, smaller merchants and smaller metal concerns are not sharing fully in the upward trend. The electrical industry is not running at as high a rate as the steel industry. However, there is no shortage of credit.

Martin states that a member of Congress had told him there were areas of distress and unemployment where credit would be helpful.

Denton comments that he would like to know of any such areas in his district so he could lend the money required.

Ireland has areas related to textiles which are not so prosperous, but the problem is not one of credit.

Campbell. In the agricultural areas there is unemployment due to acreage restrictions, but it is not a credit problem. The small merchants are affected.

Brown. The soft coal industry has problems because of oil and gas displacing coal, but the problem is not one of credit. The railroad car building industry is also somewhat depressed, but it is not a matter of credit.

Balderston. Are there evidences of a lack of prudence in borrowing, and is there borrowing for speculative purposes?

Brown. Without government backing some real estate borrowing might be considered imprudent. There does not seem to be much evidence of large inventory accumulation.

Alexander states he is not aware of any excessive inventory accumulation. There is some increase in inventories, but it is not excessive. Most large banks are being besieged by finance companies for more credit. Real estate commitments are being curtailed somewhat, and there is some extension of the commitments. Alexander does not know of any cases where credit is not available when it is sought for productive purposes.

Robertson. Are you concerned about the stretching out of terms for consumer credit?

Alexander believes there is some concern on this matter, but he reports that those in the business are not inclined to agree that there is any real reason for concern. Those in the business believe they are still being prudent.

Robertson. Are terms being used to finance or to sell cars?

Alexander. The terms are probably being used to sell cars.

Robertson. Will this affect future sales?

Alexander. The demand for cars has been strong, and people are meeting their payments. He is not certain that present terms will affect future sales unfavorably.

Vardaman. Are banks which lend to finance companies setting up larger reserves to offset longer terms and possible losses?

Alexander believes they are setting up reserves which they consider adequate.

Brown states that his bank probably lends as much or more to finance companies than any other bank. Every finance company wants increased lines. Brown does not believe there is any particular credit risk involved.

Matkin does not believe there is a problem of unemployment in the Dallas district. The problem is one of drought. Matkin believes the finance companies are inclined to give easier terms than the banks.

Ireland reports that in his district some banks are apparently giving very easy terms.

Chandler. There is little unemployment in his district, but there is an acute drought situation.

Davis. Nothing can be done in his district by credit to help any unemployment that exists. There have been problems of drought and freezes, and rural areas are suffering as a result.

Vardaman. Is the farm machinery business improving?

Brown. Farm machinery sales were very much depressed a year ago. Sales are better now, but they are still not good.

Denton reports that if auto sales decline, one steel company has advised him the demand for steel by farm machinery companies may partly offset this decline.

ITEM IV

IN ADDITION TO THE VIEWS OF THE COUNCIL ON THE GENERAL BUSINESS SITUATION, THE BOARD WOULD BE INTERESTED IN HAVING THE COUNCIL'S VIEWS AS TO THE EFFECTS OF SYSTEM CREDIT POLICIES SINCE THE LAST MEETING OF THE COUNCIL AND WHETHER THESE POLICIES SHOULD BE CHANGED IN ANY WAY IN THE LIGHT OF THE BUSINESS AND ECONOMIC SITUATION DURING THE NEAR TERM.

Brown reads Item IV and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. Brown outlines the demands for new money with which he understands the Treasury will be confronted in the last half of the calendar year. He states that the Treasury demand may coincide with heavy demands for bank credit by business. He also calls attention to the apparent change in views of the use of the discount window as expressed in one of Sproul's speeches and in the comments of other persons in the System. Brown believes that the use of the discount window should not be restricted or discouraged. If the use of the discount window becomes too heavy, the discount rate can be increased.

Martin. The System faces difficult problems in the months immediately ahead. It might be difficult to explain a reduction in reserves if business is booming. Credit policy and debt management policies will need to be meshed.

Fleming states that large insurance companies have little or no long term money available. Handling the Treasury financing will be a delicate operation.

Brown reports that no member of the Council favors raising the re-discount rate at present. There is no talk of lowering the prime rate now, but if anything is done, the prime rate will be raised. The Treasury does not like higher rates. However, if business is buoyant, and if the Treasury runs a deficit, perhaps the only answer is the healthy restraint of a rise in interest rates.

Alexander. If the guesses are right that business will continue to be exceptionally good, and if the Treasury needs new money, the Treasury may have to pay a higher rate to make its borrowings more attractive. The problem is now looming up clearly.

Mitchell thinks it may be difficult to sell securities with a maturity longer than one year.

Denton reports that banks in his area are not in a position to participate in longer term financing. He does not know how much of the problem may be solved by the use of corporate funds.

Brown. Most of the banks in his district are showing some losses in their bond accounts. The losses are principally in intermediate maturities. These banks will therefore not buy intermediate securities, but will want short-term securities.

Martin states that he would appreciate any comments from members of the Council as the time for the **financing approaches**.

Brown. The Treasury will need an increase in its debt limit.

Vardaman asks whether the money market is too tight to take care of the needs for financing.

Fleming believes the market will need reserves.

Alexander also believes the market will need reserves.

ITEM V

THE BOARD WOULD APPRECIATE RECEIVING THE COUNCIL'S VIEWS AS TO WHETHER A CHANGE IN THE SUBSTITUTION RULE UNDER REGULATIONS T AND U, TO REQUIRE THAT PROCEEDS OF SALES IN UNDER-MARGINED ACCOUNTS BE APPLIED TO REDUCE THE DEBIT BALANCE, WOULD BE DESIRABLE OR UNDESIRABLE.

Brown reads Item V and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. He does not believe the change suggested would have much effect in the banks, and he does not know to what extent it would affect the brokers. Brown also states he does not know whether the market is too high or too low. With recent stock market breaks, the illusion that the market can only move upward has been at least partly destroyed, and that is good. The brokers are accustomed to the present regulation, and a change at this time would not seem desirable.

Szymczak. The banks would not be much affected, but the brokers would be. The higher the margin requirements are, the more difficult it is to change the rule.

ITEM VI

THE PRESENT POLICY OF THE BOARD IS TO MAKE A DETERMINATION WITH RESPECT TO WHETHER THERE IS A PAYMENT OF INTEREST ON DEMAND DEPOSITS UNDER REGULATION Q ONLY AFTER DEVELOPMENT OF ALL PERTINENT FACTS THROUGH AN EXAMINATION. THE BOARD WOULD APPRECIATE HAVING THE COUNCIL'S VIEWS AS TO WHETHER VARIOUS PRACTICES BEING FOLLOWED BY BANKS RESULT IN A SUBSTANTIAL NONCOMPLIANCE WITH THE INTENT OF THE LAW OR THE REGULATION, AND WHAT, IF ANY, CHANGES IN BOARD POLICY OR IN THE LAW MIGHT BE DESIRABLE?

Brown reads Item VI and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. When a bank pays checks against an account, it renders a service and therefore pays a form of interest. The banks make no service charges when interest earned on the balances offsets the costs of handling a deposit account. In this respect banks actually pay interest indirectly. Banks also tend to give lower rates to borrowers with large accounts. This is American banking. The big problem is the absorption of exchange charges. Brown had hoped the FDIC would agree with the Board, and he hopes the Board will continue its efforts to obtain the conformity of the FDIC with the Board's views on this matter.

Ringland would appreciate the Board's opinion on this question, and what gave rise to this question in the first place.

Robertson. Mr. Brown has stated the problem exactly. You can argue each exception up one side and down the other. Robertson does

not believe any change will take place on the absorption of exchange charges by the FDIC. The last argument on this question was a "dog fight" and he sees nothing to be gained by another argument on the same subject. He believes the statute is completely unenforceable, and he cites various cases. He comments that it is unfortunate that an agency should be asked to enforce an unenforceable statute. If the Board could start from scratch, he thinks the statute should prohibit only the actual direct payment of interest credited to an account.

Matkin. If the FDIC and the Federal Reserve System could get together on the question of the absorption of exchange charges, it would eliminate one of the biggest problems.

Robertson agrees with Matkin. He states that the Comptroller and the Federal Reserve System can get together, but then it becomes a question of member and non-member banks. He believes that within fifteen years we shall have all par banks.

Mitchell. Some groups will suffer if that occurs.

Davis states that he could add additional ways in which some banks are paying interest indirectly. He is inclined to disagree with some of the views Robertson has expressed. Davis believes that one of the principal abuses is in purchasing accounts by these means. If a disapproval of flagrant practices, such as non-interest loans, were stated in the reports of the examiners, he believes the practices would end. He believes the Board could deal with the most flagrant cases. In general the problem is a self-eliminating one.

Robertson points out that the flagrant cases are included in the examiners' reports. Robertson also states that it is extremely difficult and dangerous to publish rulings without getting very specific.

Brown comments that he sees little difference in a no interest loan and a loan where you give a lower rate because of large balances. He is pleased to note that Robertson agrees regarding the inadvisability of publishing the rulings.

The meeting adjourned at 12:45 P.M.

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The next meeting will be held September 18, 19 and 20, 1955.