Minutes of session of Advisory Council with Board, at a joint meeting of the Federal Reserve Board and the Advisory Council, held in the Assembly Room, National Metropolitan Bank Building, Washington, D. C. on Monday, November 18, 1918, at 11 o'clock, A. M.

Present: Mr. Harding, presiding
Mr. Strauss
Mr. Hamlin
Mr. Miller
Mr. Williams
Mr. Broderick, Secretary.

of the Federal Reserve Board, and

Mr. Forgan
Mr. Rue
Mr. Morgan
Mr. Wing
Mr. Rowe
Mr. Norwood
Mr. Lyerly
Mr. Watts
Mr. Mitchell
Mr. Wilmot
Mr. Fleishhacker

of the Federal Advisory Council.

Present also: R. C. Leffingwell, Assistant Secretary of the Treasury.
Benjamin Strong, Governor of the Federal Reserve Bank of New York.

In opening the session, Governor Harding said:

"We are meeting today under far happier auspices than upon the occasion of our last joint session. Today we are concerned with the problems of reconstruction and peace instead of those of the prosecution of the great War. We have the pleasure of having with us today Mr. Leffingwell, Assistant Secretary of the Treasury, who is present to represent the Secretary of the Treasury. Governor Strong, of the Federal Reserve Bank of New York, is also present at our request to contribute the benefit of his views to the meeting. You have before you the topics suggested by the Board for discussion at the meeting. They are very comprehensive questions and are all inter-related, so instead of trying to discuss them in detail I believe I might better present briefly a general picture of the situation as the Board sees it.

It may be well to take a retrospective view of what the Federal Reserve Board has done during the past four years, or rather, some of the things it has not done. When the banks were organized on November 16, 1914, the shock given to credit institutions and industries by reason of the outbreak of the European War had largely subsided. Through the measures taken, and particularly through the issue of the emergency currency provided by the Aldrich-Vreeland Act, as amended by the Federal Reserve Act, the Federal Reserve Banks found themselves at the outset approaching a period of easy money. In 1915 and up to the early months of 1916, there was such a plethora of money that most of the Federal Reserve Banks were unable to make expenses, and the control contemplated over the banking situation by means of discount rates vested in the Board and the Federal Reserve Banks was nullified. Discount rates all over the country were abnormally low. As the Federal Reserve Banks were unable to get business under the prevailing low rates, they certainly would have gotten even less business at higher rates. Owing to the urgent demands of European belligerents for supplies and munitions of war for quick delivery, and as the result of their policy of shipping gold into this country in payment of their obligations here, we experienced abnormally easy-money conditions, which created a good market for foreign-owned American securities.

The result was that we gained something over a billion dollars in gold from January 1, 1915, to January 1, 1917. We saw a very large increase in the gold volume of bank credits as a result of our gold expansion.

The only period when the Federal Reserve Board was able to exercise any effective control over the banking situation was during the last two or three months of 1916, and the first quarter of 1917. You will remember that during these months the Board discouraged the purchase of municipal warrants, advanced discount rates, and advised the Federal Reserve Banks to put their affairs in the most liquid shape possible, and that very material increases in reserves had been effected by the first of April 1917. I believe you gentlemen will agree with me that the United States entered the war better prepared from a banking standpoint than in any other line of activity. After April 6,1917, as you know, war necessities became paramount and imperative. It is not within the power of any group of banks or of any banking system to regulate the financial demands of war. War is a hard taskmaster; munitions and supplies must be had at all hazards and transported to the front without delay, and the only province of the banking community in this connection is to "come across" with the capital necessary to procure the goods and man power required. The military organization makes its requisitions and all other activities must adjust themselves to the military demands. Now, we are approaching the time of general international readjustment and reconstruction, and while the war, as far as actual hostilities are concerned, is ended, it is not over in a financial sense and from a standpoint of permanent adjustment. These problems of readjustment must be met by the civil authorities of the various nations supported by their military and naval power.

The question now arises, has the time come when the Federal Reserve Banks and the Federal Reserve Board can assume to undertake any aggressive policy relating to the topics that have been suggested to you for consideration, or whether we should merely consider them and get ready for the time when we can properly undertake the exercise of all the functions entrusted to us under the terms of the Federal Reserve Act. It seems to me that we must await more settled conditions,

We have, as you know, about $2,558,000,000 of Federal reserve notes in circulation. The consolidated reserve against Federal reserve notes and deposits is today 49.9%. Looking at it in another way, if we set aside arbitrarily a reserve of 35% against deposits, we have a reserve of 59.6% against Federal reserve notes. The Federal Reserve Board announced some time ago that it would be its policy, in case these reserves should decline below the limit prescribed by law, to permit the reserve against deposits to fall as far as need be inasmuch as no penalty attaches to a deficiency in reserves against deposits and to allow the residue developed by such decline to apply as reserve against the Federal Reserve notes. As you know, if a deficiency of reserves against notes should arise it would develop perplexing complications. There is provided a penalty for deficient reserves on note issue on a graduated scale to be recouped by an addition to the discount rate. This deficiency and penalty would have to be figured out for each bank to determine what amount should be added to the discount rate to effect the recoupment. That might result in the addition of 1/42% or 1/64% to rates, so, in order to keep away from the complication, it seems far better to allow the deficient reserve to apply against deposits, where deficiencies are not penalized. Furthermore, deficiency in reserves against deposits would be less apt to create alarm than one against note liabilities. We must, of course, bear in mind that there is a point beyond which deficiency in reserves against deposits cannot be permitted.

Indications are that we are coming back rapidly to a peace basis. A great many of the restrictions imposed by the War Industries Board and other branches of Executive Departments of the Government are fast being removed. For example, the domestic use of gold and silver for industrial purposes and in the arts has been freed of restrictions. I believe that the removal of restrictions against the use of gold and silver in the arts will have a very good effect because while it may result in the presentation of some Federal Reserve notes for redemption there will be afforded an opportunity to demonstrate that the Federal Reserve note is what it purports to be - redeemable in gold - and will show the people that there is no premium on gold in this country, which can be obtained by the presentation of Federal Reserve notes.

The restrictions imposed upon the exportation of gold were made effective over a year ago (in September 1917) by an Executive Order of the President which put the whole matter in the hands of the Secretary of the Treasury, who in turn, gave to the Federal Reserve Board power to issue licenses in specific cases. The question arises as to when the Board should advise that these restrictions be modified or lifted entirely. The suggestion has been made that it would be proper to begin with the South and Central American nations. The Board itself is not unanimous on this subject. The majority of the Board is of the opinion that it would be well to be assured of our domestic position before taking any such action: to maintain the integrity of the Federal Reserve note, to be prepared to make any necessary redemptions to establish the fact that these note are always redeemable on demand in gold. So far as our dealings with foreign countries are concerned, it is evident that our exchange situation all over the world is materially improved. This more satisfactory exchange position arises from several causes -.direct negotiations by United States Treasury agents abroad and, the most compelling factor is, of course, our military success. Our present exchange situation is by no means acute.

The suggestion has been made that it would be wise policy for the Federal Reserve Banks to reduce their rates on bankers' acceptances against the exportation and importation of goods. Such a course would give the banks quickly available resources in the shape of prime investments and would enable us to meet foreign competition. There would be no reason then for anyone to hesitate as between drawing in dollars or in sterling or feel obliged to use sterling because of lower rates. In order to put the banks in a position to give these low rates it seems necessary to continue the existing rates on our internal transactions. There does not appear to be any reason why we should consider at this time any reduction of the discount rate on ninety day commercial paper or member banks' collateral notes.

Upon the entrance of the United States into the war, the Federal Reserve Board, in line with its policy of supporting the Government to the utmost of its ability, established a differential rate on paper secured by Government obligations. The rate of interest on Treasury certificates and Government bonds was established by the Secretary of the Treasury after consultation with various interests all over the country, and in order to make it possible for banks to engage in these transactions without being penalized, the Board felt that it would be helpful to establish a differential. The result has been that the invested resources of the Federal Reserve Banks are between

70% and 80% in paper secured by Government obligations and the balance in commercial obligations, with the further effect that the Federal Reserve notes outstanding are thus indirectly secured proportionately by Government obligations.

It is evident that a reduction in the Federal Reserve Banks' rate on bankers' acceptances will have a tendency to restore the proper equilibrium in the banks' invested resources and give them an opportunity gradually to work off these obligations secured by Government issues.

There is one further thought which I have not had an opportunity of discussing with my colleagues of the Board but which I venture to throw out - when the time comes for us to have larger dealings in gold with foreign countries there should be reached some definite understanding, It seems to be that before engaging in such transactions we must be assured of the responsibility of the governments with which we deal. It is, of course, obvious that our dealings with foreign countries must be based upon credit for some time to come. Mr. Leffingwell says that the Treasury expects to continue for some time to make advances to allied governments on account of their purchases in this country. When we consider our own national debt and the war obligations of Great Britain, France and Italy, we see that the smount of gold we have and the amount of gold in the world is wholly inadequate to serve as the basis for the debts. For this reason credits must be extended over a long period of years and extinguished by systematic saving and thrift. It would be absurd to attempt to set up a gold reserve against such gigantic obligations. As far as we are concerned, the gold against our Federal Reserve notes is adequate, so that, as we get the Government obligations out of the banks and get back to a basis of liquid commercial paper the notes will automatically regulate themselves and solve any currency problems which may arise, thus preventing the complications which arose at the close of the Civil War.

Whenever we establish a free gold market in this country we should be particularly careful to see that it is not one-sided and that it works both ways. Take the case of a bank which suspends business and then is reorganized within a brief period. It as a rule provides for the payment of old deposits over a period of months or years in installments. It then opens its doors for business; any new deposits coming in are subject to payment in cash on demand, old deposits being treated as time obligations until due under the terms of the agreement. It seems to me that whoever has authority in the matter should require, whenever we come to a free gold basis, some definite understanding whereby such gold operations will be engaged in as current business and upon a basis of reciprocity, so that whenever our trade balance should permit or require there should be no obstruction to our drawing in gold because of the erection of artificial barriers on account of old war debts. Unless our free gold market is established upon that basis, a nation might withdraw gold and impound it as a reserve against its war debts instead of treating the gold transaction as one of current business.

The topics submitted to you for consideration cover the entire field of our financial problems, and in closing I would like to call the attention of the Council to that provision of Section 12 under which it has come into existence. I wish to express also, in behalf of my colleagues and myself, appreciation of the very considerate way in which you have treated the Board in all our discussions. It seems to me that you have gone even beyond the bounds of courtesy in deferring to the Board, and I would like to call attention to the fact that this Advisory Council is a body organized by Congress with certain specific powers. It has the right not only to advise the Board but also to criticize its actions; it has the right to call for any specific information it desires and to ask "the reason why". As far as I am concerned (and I am sure my colleagues of the Board take the same view) I would welcome any suggestion and also any inquiry that you wish to make as to the why's and wherefore's of the Board policies. It seems to me that the adoption of a policy of this sort by the Council would be very helpful just now in building up some constructive policy upon which to base our work from this time forth. We have here a body of representative bankers from all sections of the country and certainly their views individually as well as collectively would be of great value to the country, so I hope you will not defer too much to the Board and that you will be as assertive as you please in order that we may have a friendly discussion of any matters which you may deem important.

Mr. Wilmot. Governor Harding, how much free gold has the Federal Reserve System now on hand?

Governor Harding: About $500,000,000. The issue of Federal Reserve notes has not been materially increased for the past thirty days and the crop moving is pretty well advanced and there should be some contraction of the note issues during the next sixty days.