The original documents are located in Box C17, folder "Melnicoff, David C." of the Arthur F. Burns Papers at the Gerald R. Ford Presidential Library.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Date May 29, 1974

To Governors Mitchell and [illegible] 1974 MAY 29 AM 10:50 Subject:

From David C. Melnicoff
DCM.

RECEIVED
OFFICE OF THE CHAIRMAN

GC
JW.
H. 1

The attached excerpt from the full-page advertisement of The New York Bank for Savings describes a consumer service which promises to break the "NOW Account" experiment wide open.

The savings banks have inaugurated a service which allows a customer to transfer funds -- immediately by telephone, or automatically by prearrangement -- from an interest-bearing account to a noninterest-bearing checking account. This establishes a situation in which there is de facto payment of interest on demand accounts.

The Board has prohibited such telephone or automatic transfers on the grounds that it creates an arrangement which is tantamount to the payment of interest on demand accounts. The Board reiterated its position in a reply to a Boston commercial bank which requested approval of this arrangement as an alternative to the establishment of NOW Accounts.

It is reported that the FDIC has acquiesced in this savings bank promotion as being consistent with their rules. Our legal staff is researching the matter thoroughly, and will give its views in a memorandum elaborating on the situation in Massachusetts.

The Board is in an exposed position here. Some action seems called for -- either a statement of protest or a reinterpretation of the rules to give commercial banks equal powers. Occasional violations of the Board's rules in the hinterland have escaped national notice. This latest plan, however, is plastered all over the New York Times and is being implemented in the nation's largest metropolitan area. At the very least, an immediate contact with the Coordinating Committee seems appropriate.

Attachment

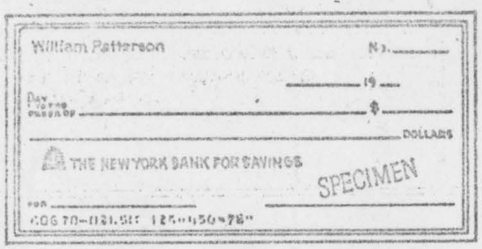
cc: Chairman Burns
Mr. Kudlinski
Mr. Krabill
Mr. Raiken
Mr. Puckett

GERALD R. FORD LIBRARY

introduces two new accounts!

PAYMENT ACCOUNT!

Free Payment Orders when you maintain a $500 minimum balance.

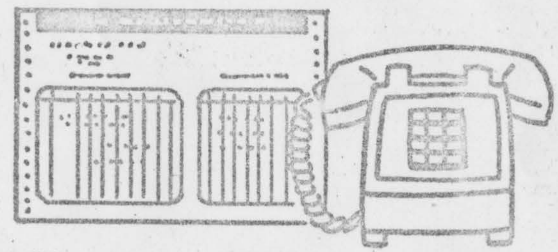


Use these handy new Payment Orders to pay your regular monthly bills or to send money. Payment Orders are negotiable and go through regular bank channels. When cancelled, they are returned to you as records of your payment along with your monthly statement. As you use up your Payment Order blanks, you simply order a new supply at no cost. If your balance drops below the $500 minimum, a small service charge is made for that month. This is a non-interest earning account.

Of course, you must maintain sufficient funds in your Payment Account to meet your Payment Orders as they are presented.

DAY TO DAY NO-PASSBOOK SAVINGS ACCOUNT!

With 2 special transfer features.



You earn the highest rate permitted for Day to Day Savings Accounts—5.47% annual yield on 5.25% a year latest dividend, compounded daily and credited quarterly. Dividends paid for every day on deposit, provided a $1 balance remains to the end of the quarter. Dividends must remain on deposit full year to earn the 5.47% yield.

Two special transfer features are offered for your convenience. At any time, you may call us by telephone and we'll transfer the desired amount from your account to another account or mail you a check. Or if you wish to receive money on a regular basis, you can authorize us in advance and we'll send you a specified amount monthly or transfer it to another account on an automatic basis. A monthly statement covers all your transactions. A $500 minimum balance is required.

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

Date: January 23, 1974

To: Chairman Burns

From: DAVID C. MELNICOFF

Norman Strunk of the United States Savings and Loan League called late last week to get some further explanation of our difficulty with the Home Loan Bank Board's NOW Account regulations. I explained the difference between our rules and the Home Loan Bank Board's, and our concern that the use of NOW Accounts by others than individuals could lead to the creation of a very different kind of animal than the Congress anticipated.

Norman indicated that he had gloated a little about the savings and loan industries' ability to steal the march on the banks this time. However, on reflection, and after talking with you at the savings and loan dinner, he appreciates that allowing NOW Accounts to move too far too fast might boomerang. He indicated that he would talk with Tom Bomar, and that he might exert some influence in the direction of uniformity among the agencies.

cc: Governor Mitchell

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 14, 1973

To Chairman Burns

Subject: Subject for Board Discussion

From David C. Melnicoff

DM

Governor Bucher is eager to schedule this memorandum for Board discussion. It asks the Board's agreement in his initiative to obtain a top-level Director of Public Information for the Board. The matter should be discussed at an executive session.

You have discussed this with Governor Bucher previously and have indicated your agreement in principle. In view of the current budget situation, however, do you want to undertake now a course of action that will cost at least $50,000 a year?

This could be distributed immediately for discussion tomorrow. If you do not wish it placed on the agenda, it might be well to mention it to Governor Bucher.

Attachment

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 2, 1973

To Board of Governors

Subject: Public Information Program

From Governor Bucher

~~CONFIDENTIAL (FR)~~

Over the past several months, I have made an effort to better understand the Board's public information program. Each of you have expressed your views on this subject and in the process helped me to assess the situation. The Executive Director and other staff members have provided valuable insights into present activities in member bank relations, the media, publications and more generally the public.

In this connection, I want to set forth one of my conclusions for your consideration. I believe the Board of Governors should seriously consider the recruitment of an experienced professional in the public information field. Such an individual would be an official of the Board's staff, function as program director, report to the Chairman and Board at large through me, and be responsible for shaping information policies and programs of the Board. In my mind the Board's present staff and their activities are more than satisfactory for day-to-day operations. At the same time, it is clear to me that the organization of the present information function is somewhat fragmented, lacking in broad gauge leadership and unable to cope with the policy issues and strategic decisions that we know to exist in virtually all dimensions of this program. Among these are:

1. The System's contacts with the banking system and with nonbank financial institutions have proliferated in recent years. The scope of the Board's regulatory activities has been broadened and the task of providing information and obtaining feedback is more complex. Furthermore, our membership problems deserve study from the viewpoint of a communications expert.

2. The Board is involved with consumer protection measures in an era of widening concern for consumer protection. This creates a communications problem of a type which the Board did not face until recent years.

DECLASSIFIED
AUTHORITY Federal Reserve System letter, 11/16/82
BY JPS NARA, DATE 3/7/2013

GERALD R. FORD LIBRARY

3. The information needs of the public at large as well as the Board's social responsibilities in this regard are indistinct and in need of study.

4. The System's public information program should integrate, to some extent at least, the objectives and activities of the Board and the Federal Reserve Bank.

The communications environment in which the Board will be operating over the next several years will become increasingly complicated. This environment from the Board's point of view has significant opportunities for improved understanding of the Board's purpose and functions. By acting now in appointing a program director for public information, I think we could make progress. With the Board's agreement, I will initiate action to identify a suitable candidate.

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date September 11, 1973

To Board of Governors

Subject: Meeting with CSBS on Friday, September 14, 1973

From David C. Melnicoff

Attached is an informal agenda for the meeting with the Board of Directors of the Conference of State Bank Supervisors on Friday, September 14th.

The first two items were suggested by CSBS. The third and fourth items were suggested by us. As part of the fourth item, the Board may wish to request the cooperation of the State Bank Supervisors in securing the voluntary participation of nonmember banks in the marginal reserve program.

In attendance at the meeting will be the following supervisors:

Fred O. Dickinson, Jr. -- Florida -- 1st V.P.
James E. Faris -- Indiana -- 2nd V.P.
W. Smoot Brimhall -- Utah -- Past President
Harry Bloom -- Colorado -- Secretary-Treasurer
Erich L. Mildenberg -- Wisconsin
James E. Hagen -- Connecticut
John B. Olin -- Oregon
Harry W. Albright, Jr., -- New York
H. Robert Bartell, Jr. -- Illinois
Robert C. Cleveland -- South Carolina
Roy W. Davidson -- New Mexico

In addition, Dr. Kreider, Executive Vice President of the Conference, will attend.

Attachment

AGENDA

Meeting with the Board of Directors
of the
Conference of State Bank Supervisors
10:00 a.m.
Friday, September 14, 1973
Board Room

1. The CSBS/FDIC examination experiment

   Messrs. Pearson and Ferris will present a report on a cooperative venture

2. CSBS' efforts to facilitate monetary policy:

   a. Flexibility in State mortgage interest rate ceilings
   b. Retention of State requirements during tight money periods

      Mr. Kreider, Executive Vice President of CSBS, will describe some activity intended to reinforce monetary policy actions

3. Federal Reserve proposals for universal reserve requirements:

   a. Maintenance of the dual banking system
   b. Implications of reserves for monetary policy

      Board Members, Mr. Cardon, and Mr. Axilrod

4. Recent experience with voluntary reserves set-asides and implementation of September 7 marginal reserve action for nonmembers.

   Board Members, Mr. Melnicoff, and Mr. Axilrod

Additional 3%

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

Date: September 13th

To: All Board Members

From: DAVID C. MELNICOFF

For your information prior to tomorrow's meeting with representatives of the Conference of State Bank Supervisors.

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 24, 1973

To Chairman Burns

From David C. Melnicoff

Subject: Talking points on Reserves for Nonmembers

Arguments opposing the requirement that prescribed reserve accounts be held in Federal Reserve Banks by nonmember banks (which might be extended by analogy to State chartered savings institutions) fall under three headings:

A. Such requirements will destroy correspondent banking and the dual banking system;

B. The present system is equitable as between members and nonmembers; and

C. The effectiveness of monetary policy actions is not diminished by failure of nonmembers to maintain Federal Reserve Board reserve accounts.

In rebuttal:

A. Concerning the dual banking system --

1. Imposition of reserve requirements does not eliminate State chartering, State laws with respect to banking structure, or State prerogatives as to supervision and regulation.[1] (FDIC supervision of nonmembers has long since shared the examination function and made nonmember merger determinations.)

2. Federal Reserve Banks do not provide many of the important correspondent bank services and will not. (Member banks

---

1/ Principal difference in this connection is the ability of nonmember bank officers -- not available to members -- to undertake interlocking relations with other banks and securities companies.

now maintain substantial correspondent bank accounts.) Moreover, if reserve equality is achieved, the Federal Reserve Banks will be free of the need to provide members with "compensatory" services. "Fee for service" principle is likely to be more widespread within the Federal Reserve System and among correspondent banks, and competition is likely to be keener. Compensation for correspondent services need not depend on compensating balances.

3. The dual banking system is somewhat of a sacred cow, or perhaps a red herring, in that the FDIC has already diluted its impact. Thrift institutions and nonbank financial institutions really provide a pluralistic banking system for the public.

The only real purpose for the continuation of "dual banking" appears to be the protection it affords against reserve requirements for State banks.

B. Concerning equity

1. State bank reserve requirements, which vary from State to State, are often lower than the Federal Reserve schedule. (See Table, Exhibit

2. Even where State requirements are nominally the same as those of of the Federal Reserve, State requirements are always less onerous by virtue of

   a. The ability to hold prescribed reserves in correspondent banks, thus compensating for necessary services;

   b. The ability to count cash items in process of collection as reserves;

c. In some States, the ability to hold reserves in the form of interest-bearing securities.

3. Conference of State Bank Supervisors argument that total nonearning assets for members and nonmembers are roughly equal is not valid.

a. Statistical omissions

Kreider* presentation fails to take cash items in process of collection ("float") into account. (Nonearning assets are 19.5 per cent of deposits for member, 10.8 per cent for nonmembers.) (See Table, Exhibit B)

b. Analysis of individual cases

i. Wilmington Trust (deposits $500 million) freed $24 million of previously sterile reserves when it dropped system membership in 1972. Potential after-tax improvement in earnings was 9 to 13 per cent.

ii. Valley National (total deposits $2 billion) would, if it drops membership, free its entire $111,000,000 reserve account for investment, making up its State requirement from existing Treasury securities and correspondent balances, including cash items in process of collection.

c. Recent membership trends

i. Since 1960, about 700 banks have left the System through withdrawal or mergers.

ii. Of 1,600 banks receiving State charters since 1960, only 100 have elected to join the System.

* Economist for Conference of State Bank Supervisors

GERALD R. FORD LIBRARY

iii. During 1972, five banks with deposits of $100 million or more left the System.

iv. During the first five months of 1973, 33 banks left the System, 14 by conversion of charter and 19 by withdrawal.

v. Deposits subject to reserve requirement have declined from 86 to 78 per cent of total deposits between 1945 and present.

4. Technology, banking practice, and need for sound banking system is reducing exclusivity of Federal Reserve services.

   a. Many nonmembers clear a large portion of their checks through Federal Reserve RCPC's in interest of float reduction, efficiency, and convenience to the public. Many nonmembers also receive the benefit of low cost Federal Reserve coin and currency runs. Emolution of electronic funds transfer systems points to more universal payments services.

   b. Development of Federal funds market and equivalent day-to-day borrowing devices have reduced need for discount window somewhat, except under conditions of severe stringency. (Monetary policy would be better served, however, if all had access.)

   c. Federal Reserve must and does stand ready in emergencies to lend to nonmembers and other financial institutions.

5. A special banking "tax" is avoided by nonmembers. Since Federal Reserve income is turned over to Treasury, members may be said to pay a special tax via reserves held with Federal Reserve.

C. Monetary policy considerations

1. Universal reserves are prerequisite for improving precision of monetary control

GERALD R. FORD LIBRARY

a. Eliminate changes in money multiplier as result of shift of funds in and out of reserve and nonreserve institutions.

b. Base for System reserve (including open market) operations is declining in absence of equal treatment, thus weakening linkages between reserves under control of Fed and deposit growth.

2. State reserve requirements do not aid in problems of reserve and money management.

a. Deposits in other banks are used to support expansion of credit. (Possible to play "ring-around-the rosy")1/

b. Use of securities as reserves provides avenue for expansion of reserves (at option of bank) effectively without limit. "It is the essence of monetary control throuth the reserve instrument that the supply of reserves be capable of close control by the central bank, so that the supply of reserves can be changed relative to the demand for reserves imposed by the percentage of reserve requirement." (Partee)

3. Every study group or commission in recent years has endorsed universal reserves on these grounds.

a. Douglas subcommittee of JEC in 1950

b. Patman subcommittee of JEC in 1952

c. CED Commission on Money and Banking in 1961

d. President's Committee on Financial Institutions in 1963

e. Hunt Commission

1/ It is possible (and it has happened) that State "reserves" deposited by Bank A in Bank B are redeposited by Bank B in Bank C and, in turn redeposited in Bank A. This is tolerated by B because A's "reserve" balance is more than enough to compensate for B's services. C takes a little rake-off along the way.

<u>A fall-back position</u>: (See Table, Exhibit C)

A. Exempt banks under $5 million demand deposits

1. 5,526 of 8,085 nonmember banks exempt;

2. 24 per cent of nonmember demand deposits; 4.9 per cent of all bank demand deposits exempt;

3. 7.6 per cent of demand deposits exempt if <u>all</u> banks, member and nonmember, under $5 million demand deposits excluded.

B. Exempt banks under $10 million total demand deposits

1. 7,003 of 8,085 nonmember banks would be exempt;

2. 44 per cent of nonmember demand deposits; 8.9 per cent of all bank demand deposits;

3. If exemption of all banks -- member and nonmember -- of this size is eventually required, 15.5 per cent of total bank demand deposits would be free of requirement.

GERALD R. FORD LIBRARY

Exhibit A

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 20, 1973

To Mr. Melnicoff

Subject: State Reserve Requirements

From H. White

HW

The attached schedule shows state reserve requirements for demand and time deposits of commercial banks. The right hand column is of particular importance, because it shows the per cent of reserves that can be maintained in the form of interest-bearing securities. Thus, for example, Colorado appears to have reserve requirements that are only slightly lower than the Federal Reserve requirements, but in reality they are considerably lower because 100 per cent can be maintained in the form of interest-bearing securities.

The portion of state reserves not held as securities or as vault cash is held in the form of correspondent deposit balances with other banks. Such deposits serve a dual purpose in that they also compensate the correspondent for a variety of check clearing and investment services. Federal Reserve member banks also receive some similar services free from the Reserve Banks.

The note in the heading of the right hand column is also important in that it indicates that the demand balances held in banks may be in either collected or uncollected form. This fact is doubly significant because state nonmember banks generally do not use an account called "Cash items in the process of collection," but instead they post all collection items immediately in "Due from banks." The effect of this can best be illustrated by an example. Suppose a check drawn on an out-of-town bank is received for collection by a state nonmember bank on a Tuesday and dispatched that evening for a correspondent clearing bank. The check would normally be received by the correspondent on the following day (Wednesday), and the check would normally be collected on either Thursday or Friday depending on the location of the drawee bank. Therefore, the amount of the check does not become collected funds to anyone until Thursday or Friday, but the nonmember can include the amount of this check as part of its state reserves beginning on Tuesday when it received the item and posted it to "Due from banks."

Nonmember banks, therefore, have an advantage both in holding a portion of their reserves in the form of earning assets, and in counting uncollected balances to fulfill their state reserve requirements. In contrast, member bank reserves must be maintained in the form of collected balances in a Reserve Bank, and no interest is paid on these balances.

Attachment

GERALD R. FORD LIBRARY

Exhibit B

Ratios of the Sum of Currency and Coin, Reserve With Federal Reserve Banks, Demand Balances With Banks in the United States, and Cash Items in the Process of Collection to Total Deposits and to Total Assets, Insured Commercial Banks, United States, December 31, 1972

(In per cent)

Bank Deposit Size (in dollars)	Member Banks Deposit Ratio	Member Banks Asset Ratio	Nonmember Banks Deposit Ratio	Nonmember Banks Asset Ratio
5B+	25.75	20.10		
3 - 5B	26.74	20.68		
1 - 3B	20.35	16.08	1/	1/
750M - 1B	17.64	14.64	13.71	11.96
500 - 750M	18.53	15.37	9.46	8.11
400 - 500M	18.23	15.48	0.00	0.00
300 - 400M	16.17	13.58	10.23	8.92
200 - 300M	17.41	15.07	11.87	10.40
100 - 200M	15.32	13.30	11.83	10.41
75 - 100M	13.83	12.25	9.87	8.69
50 - 75M	13.82	12.25	10.26	9.12
25 - 50M	13.00	11.55	10.00	8.88
10 - 25M	12.69	11.39	10.60	9.50
5 - 10M	13.07	11.70	11.11	9.96
2 - 5M	14.67	13.02	11.91	10.61
1 - 2M	16.18	12.66	15.99	13.50
0 - 1M	35.69	18.58	22.94	17.44
Average	19.46	16.04	10.79 1/	9.57 1/

1/ Average includes data from one nonmember bank in the $1 - 3B deposit size category. Data for that bank, however, are not reported in the third line of the body of the table so as to avoid the possibility of unnecessarily revealing confidential information.

GERALD R. FORD LIBRARY

State Reserve Requirements for Commercial Banks
In effect March 20, 1973

	Reserve requirement shown as percentage — Demand	Time	Unless otherwise indicated reserves must be held in vault cash, demand balances in banks (collected and uncollected)*
Federal Reserve (Reserve City)	\$50,760,000 plus 17½% of amt. in excess of \$400MM	3 Savings & club accts. 3 Other under \$5MM 5 Other over \$5MM	Demand balances must be in Reserve Bank
Federal Reserve (Not in Reserve City)	Under \$2MM - 8 \$2MM to 10MM - \$160,000 plus 10% of amt. over \$2MM \$10MM to 100MM - \$960,000 plus 12% of amt. over \$10MM Over \$100MM - \$11,760,000 plus 13% of amt. over \$100MM	3 Savings & club accts. 3 Other under \$5MM 5 Other over \$5MM	Demand balances must be in Reserve Bank
Alabama	11	3	
Alaska	20	8	
Arizona	10	4	
Arkansas	Same as FR	Same as FR	
California	Same as FR	5	80% T in U. S. securities
Colorado	15	15	100% in U. S. securities
Connecticut	12 up to \$5MM 12½% over \$5MM	0 Savings 5 Other	16.7% in U. S. securities
Delaware	8 up to \$100MM 10 over \$100MM	3	
Florida	20	20	100% in U. S. securities
Georgia	15	5	100% T in U.S. or Ga. sec. 50% D in U. S. sec. maturing within 1 yr. or CD's
Hawaii	12	5	xxx
Idaho	15	15	33-1/3% in U. S. sec.
Illinois	0	0	
Indiana	10	3	
Iowa 1/	7	3	
Kansas	12½ (20 - deposits of other banks)	5	
Kentucky 2/	7	3	25% D, 100% T in U. S. or Ky. sec. or CD's
Louisiana	20	0	
Maine	8 up to \$10MM 12 over \$10MM	3 Savings Other: 3 up to \$5MM Other: 5 over \$5MM	
Maryland	15	3	100% T in U. S. or Md. sec.
Massachusetts 3/	15	0	80% in U. S. or Mass. sec.
Michigan	11	6	90% T in U. S. sec.
Minnesota	12	3	30% in U. S. sec. maturing within 1 yr.
Mississippi	Same as FR	Same as FR	30% in U. S. sec. (1/2 of the 30% may be in CD's)
Missouri	Same as FR	3	
Montana	8 up to \$2MM 10 over \$2MM	3	
Nebraska 4/	15	5	50% in U. S. sec.
Nevada	Same as FR	Same as FR	
New Hampshire	12	5	40% in U. S. sec. maturing within 2 yrs.
New Jersey	Same as FR	Same as FR	
New Mexico	12	4	50% in U. S. sec. maturing within 100 days
New York	1% less than FR	1% less than FR	
North Carolina	15	5	
North Dakota	8	2	
Ohio	7	3	60% T in U. S. sec.
Oklahoma 5/	Same as FR	Same as FR	
Oregon	12	4	60% T in U. S. sec. maturing within 1 yr.
Pennsylvania	12	3 up to \$5MM 5 over \$5MM	50% in U. S., U.S. Agency or Penn. sec.
Rhode Island	15	0	60% in U. S. sec. maturing within 91 days
South Carolina	7	3	
South Dakota	17½	17½	60% in U. S. sec.
Tennessee	10	3	
Texas	15	5	
Utah	Same as FR	Same as FR	
Vermont	27	7	(1/3 of 60% in Vt. sec.) 60% in U. S. sec. maturing in 1 yr.
Virginia	10	3	
Washington	Same as FR	Same as FR	
West Virginia	7	3	
Wisconsin 6/	12	12	33-1/3% D and 58.3% T in U.S. sec. maturing in 18 mos.
Wyoming	20	10	50% in Treasury Bills

1/ 10 per cent of demand deposits of banks located in reserve city.
2/ 10 per cent of demand in reserve cities.
3/ In Boston: 20 per cent of demand
4/ In cities of 25,000 or more 20 per cent demand.
5/ Except, 12 per cent on demand over \$10 million.
6/ 20 per cent for commissioner approved "reserve" banks.
* Figures below represent per cent of reserve requirement. "D" indicates reserve requirement on demand deposits. "T" indicates reserve requirement on time deposits.

MEMBER AND NONMEMBER BANK DEMAND DEPOSITS
BY SIZE CLASS INTERVAL -- March 31, 1973
(Amounts in millions of dollars)

Class Interval of Demand Deposits	Number of Banks	Number of Banks Cumulative	Percent of Total Demand Deposits	Percent of Total Demand Deposits Cumulative	Number Nonmember Banks	Number Nonmember Banks Cumulative	Percent of Total Nonmember Demand Deposits	Percent of Total Nonmember Demand Deposits Cumulative	Percent of Total Commercial Bank Demand Deposits	Percent of Total Commercial Bank Demand Deposits Cumulative
over 1000	24	13,766	28.4	100.0	-	-			-	-
500-1000	38	13,742	10.3	71.7	-	-			-	-
100-500	246	13,704	20.6	61.4	36	8,085	13.6	100.0	2.8	20.4
50-100	253	13,458	6.9	40.8	71	8,049	9.0	86.3	1.8	17.6
25-50	525	13,205	7.0	33.9	161	7,978	10.6	77.3	2.2	15.8
10-25	1,926	12,680	11.4	26.9	814	7,817	23.1	66.7	4.7	13.6
5-10	2,897	10,754	7.9	15.5	1,477	7,003	19.4	43.6	4.0	8.9
2-5	4,514	7,857	5.9	7.6	2,856	5,526	17.9	24.2	3.6	4.9
1-2	2,389	3,343	1.4	1.7	1,845	2,670	5.2	6.3	1.1	1.3
under 1	954	954	.3	.3	825	825	1.1	1.1	0.2	.2
TOTALS	13,766		100.0		8,085		100.0		20.4	

Talking Points
Universal Reserve Requirements

Voluntary Program for Nonmember Banks

1. Request.

Letters were sent to 184 domestic nonmember banks and to 112 foreign-owned banks, branches, and agencies. Domestic nonmembers covered were banks with total deposits of $100 million or more and certain others likely to have holdings of large CD's totaling $10 million or more.

2. Response.

(a) We have records of responses from 112 domestic nonmember banks contacted, either by letter or by contact with a Federal Reserve Bank. Fifty-four banks have agreed to cooperate and 24 have declined, although in each group there are banks below the $10 million cutoff. All foreign-owned banks, branches or agencies have agreed to cooperate.

(b) As of September 9, 1973, 75 reserve accounts for nonmember banks (including foreign affiliates) had been established at Federal Reserve Banks, totaling $23.9 million.

3. Significance.

(a) While the number of domestic nonmember bank participants relative to the total is small, 30 of the cooperating banks hold $100 million or more in deposits. Total deposits of participating banks represent well over 50 per cent of total deposits held by nonmember banks.

(b) This program has been undertaken solely in the interests of monetary policy. If the inflationary expansion of bank credit is not reduced, the entire banking system, member and nonmember, will suffer as will the public interest.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 24, 1973

To Chairman Burns

From David C. Melnicoff

Subject: Talking points on Reserves for Nonmembers

Arguments opposing the requirement that prescribed reserve accounts be held in Federal Reserve Banks by nonmember banks (which might be extended by analogy to State chartered savings institutions) fall under three headings:

A. Such requirements will destroy the correspondent banking and the dual banking system;

B. The present system is equitable as between members and nonmembers; and

C. The effectiveness of monetary policy actions is not diminished by failure of nonmembers to maintain Federal Reserve Board reserve accounts.

In rebuttal:

A. Concerning the dual banking system --

1. Imposition of reserve requirements does not eliminate State chartering, State laws with respect to banking structure, or State prerogatives as to supervision and regulation.[1/] (FDIC supervision of nonmembers has long since shared the examination function and made nonmember merger determinations.)

2. Federal Reserve Banks do not provide many of the important correspondent bank services and will not. (Member banks

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1/ Principal difference in this connection is the ability of nonmember bank officers not -- available to members -- to undertake interlocking relations with other banks and securities companies.

now maintain substantial correspondent bank accounts.) Moreover, if reserve equality is achieved, the Federal Reserve Banks will be free of the need to provide members with "compensatory" services. "Fee for service" principle is likely to be more widespread within the Federal Reserve System and among correspondent banks, and competition is likely to be keener. Compensation for correspondent services need not depend on compensating balances.

3. The dual banking system is somewhat of a sacred cow, or perhaps a red herring, in that the FDIC has already diluted its impact. Thrift institutions and nonbank financial institutions really provide a pluralistic banking system for the public.

The only real purpose for the continuation of "dual banking" appears to be the protection it affords against reserve requirements for State banks. (SEE HOWEVER "E")

B. Concerning equity

1. State bank reserve requirements, which vary from State to State, are often lower than the Federal Reserve schedule. (See Table, Exhibit A)

2. Even where State requirements are nominally the same as those of of the Federal Reserve, State requirements are always less onerous by virtue of

   a. The ability to hold prescribed reserves in correspondent banks, thus compensating for necessary services;

   b. The ability to count cash items in process of collection as reserves;

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c. In some States, the ability to hold reserves in the form of interest-bearing securities.

3. Conference of State Bank Supervisors argument that total nonearning assets for members and nonmembers are roughly equal is not valid.

a. Statistical omissions

Kreider presentation fails to take cash items in process of collection ("float") into account. (Nonearning assets are 19.5 per cent of deposits for member, 10.0 per cent for nonmembers.) (See Table, Exhibit B)

b. Analysis of individual cases

i. Wilmington Trust (deposits $500 million) freed $24 million of previously sterile reserves when it dropped system membership in 1972. Potential after-tax improvement in earnings was 9 to 13 per cent.

ii. Valley National (deposits $900 million) would, if it drops membership, free its entire $111,000,000 reserve account for investment, making up its State requirement from existing Treasury securities and correspondent balances, including cash items in process of collection.

c. Recent membership trends

i. Since 1960, about 700 banks have left the System through withdrawal or mergers.

ii. Of 1,600 banks receiving State charters since 1960, only 100 have elected to join the System.

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iii. During 1972, five banks with deposits of $100 million or more left the System.

iv. During the first five months of 1973, 33 banks left the System, 14 by conversion of charter and 19 by withdrawal.

v. Deposits subject to reserve requirement have declined from 86 to 78 per cent of total deposits between 1945 and present.

4. Technology, banking practice, and need for sound banking system is reducing exclusivity of Federal Reserve services.

a. Many nonmembers clear a large portion of their checks through Federal Reserve RCPC's in interest of float reduction, efficiency, and convenience to the public. Many nonmembers also receive the benefit of low cost Federal Reserve coin and currency runs. Development of EFTS points to more universal payments services.

b. Development of Federal funds market and equivalent day-to-day borrowing devices have reduced need for discount window somewhat, except under conditions of severe stringency. (Monetary policy would be better served, however, if all had access.)

c. Federal Reserve must and does stand ready in emergencies to lend to nonmembers and other financial institutions.

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5. A special banking "tax" is avoided by nonmembers. Since Federal Reserve income is turned over to Treasury, members may be said to pay a special tax via reserves held with Federal Reserve.

C. Monetary policy considerations

1. Universal reserves are prerequisite for improving precision of monetary control

a. Eliminate changes in money multiplier as result of shift of funds in and out of reserve and nonreserve institutions.

b. Base for System reserve (including open market) operations is declining in absence of equal treatment, thus weakening linkages between reserves under control of Fed and deposit growth.

2. State reserve requirements do not aid in problems of reserve and money management.

a. Deposits in other banks are used to support expansion of credit. (Possible to play "ring-around-the rosy")1/

b. Use of securities as reserves provides avenue for expansion of reserves (at option of bank) effectively without limit. "It is the essence of monetary control throuth the reserve instrument that the supply of reserves be capable of close control by the central bank, so that the supply of reserves can be changed relative to the demand for reserves imposed by the percentage of reserve requirement." (Partee) (EXHIBIT "D")

3. Every study group or commission in recent years has endorsed universal reserves on these grounds.

a. Douglas subcommittee of JEC in 1950

b. Patman subcommittee of JEC in 1952

c. CED Commission on Money and Banking in 1961

d. President's Committee on Financial Institutions in 1963

e. Hunt Commission

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1/ It is possible (and it has happened) that State "reserves" deposited by Bank A in Bank B are redeposited by Bank B in Bank C and, in turn redeposited in Bank A. This is tolerated by B because A's "reserve" balance is more than enough to compensate for B's services. C takes a little rake-off along the way.

<u>A fall-back position</u>: (See Table, Exhibit C)

A. Exempt banks under $10 million total deposits

   1. 4,812 of 8,085 nonmember banks would be exempt;

   2. 18 per cent of nonmember deposits; 3.9 per cent of all bank deposits;

   3. If exemption of all banks -- member and nonmember -- of this size is eventually required, 6.0 per cent of total bank deposits would be free of requirement.

B. Exempt banks under $25 million total deposits

   1. 7,009 of 8,085 nonmember banks exempt;

   2. 44 per cent of nonmember deposits; 9.6 per cent of total deposits; 17 per cent of total deposits exempt if <u>all</u> banks under $25 million excluded.

GERALD R. FORD LIBRARY

FR 468
(Rev. 3-63)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMO Date 6/8/73 Time

To: Chairman Burns

From: David C. Melnicoff

Tel. No. Ext.

☐	Please call	☐	For your approval
☐	Returned your call	☐	For your information
☐	Will call again	☐	Note and return
☐	Phone me re attached	☐	For comments and suggestions
☐	See me re attached	☐	Preparation of reply

MESSAGE:

We are proceeding along the lines recommended in the attached memorandum to launch data collection arrangements for monitoring bank performance under the April 16 criteria. Specifically, respondents in the existing CID rate survey would be asked to report their small business prime rate monthly and the volume of loans outstanding to farmers, small businesses, and all businesses quarterly.

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 7, 1973

To Mr. Melnicoff

Subject: Monitoring Requirements for April 16 Guidelines.

From J. B. Eckert

Issuance of the commercial bank interest rate criteria and subsequent questions and answers has generated additional CID monitoring responsibilities. This memorandum examines available sources of data that might satisfy the new requirements and outlines specific proposals for filling any remaining gaps.

The only new data that appear to be required are the small business prime rate and some measure of credit availability for small businesses and farmers. This information probably can be collected most conveniently in the existing CID-sponsored commercial bank survey, in which we already obtain monthly rate information on small business, farm production, and selected categories of consumer instalment loans. It is recommended that this survey be expanded to obtain monthly reporting of the small business prime rate and quarterly information on loans outstanding to farmers, small businesses, and all businesses. The present supplement to the Quarterly Interest Rate Survey covering compensating balance requirements on business loans, which was introduced on behalf of the CID last year, should be terminated.

In connection with the development of bank interest rate criteria, Chairman Burns requested that the staff arrange to collect information on the new small business prime rate. This information could best be obtained by adding a line to the existing monthly commercial bank rate survey (Form F.R. 835--copy attached). Since the criteria allow banks flexibility in allocating permissible rate increases among various categories of "regulated" loans, we should retain existing reporting of rates on specific categories of small business and farm production loans to provide some check on how any rate adjustments are being distributed. We should also retain existing reporting of compensating balance requirements for these loan categories in order to check for possible evasion of the rate criteria through changes in such requirements.

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In connection with the instruction that banks are to continue to meet legitimate credit needs of home buyers, consumers, small business, and farmers, paragraph 14 of the criteria also states that periodic reports will be required to assure that these needs are being met. In response to a request for further clarification on this point in the press conference, Chairman Burns indicated that the Committee had no specific measure or formula in mind; rather, it would follow credit developments in these areas and evaluate them in light of the developing economic situation.

The most readily available type of information that would provide a basis for appraising whether credit needs are being met is the amount of loans outstanding. Fortunately, for all the above categories except loans to small businesses and farmers, adequate periodic information on the volume of loans outstanding appears to be available from existing reports. The nature and coverage of these reports is outlined below:

(1) Call Report--a detailed loan schedule is submitted as of June 30 and December 31 by all commercial banks. Included in this schedule are the following loan categories of special interest to the Committee: (a) loans to farmers, together with a separate total for loans secured by farm land, (b) loans secured by 1-to 4-family residential properties, with a breakdown showing FHA, VA, and conventional mortgages, and (c) consumer loans, including separate totals for auto loans, other consumer goods instalment loans, retail credit card plans, check credit and revolving credit plans, home repair and modernization loans, other personal instalment loans, and single payment loans. Total commercial and industrial loans also are reported, but there is no breakdown for loans to small businesses.

(2) Weekly report of condition--a detailed balance sheet is submitted weekly by about 330 of the largest banks. Data on outstandings are available for commercial and industrial, agricultural, real estate, and consumer instalment loans.

(3) Survey of mortgage lending activity--information is collected monthly from a sample of 275 commercial banks by FDIC on behalf of HUD. The sample banks, which include about 100 of the largest commercial bank mortgage lenders, account for over 35 per cent of total mortgage loans outstanding at commercial banks. The reported information, which is highly detailed, includes data on outstandings, acquisitions, and dispositions of mortgages on farm and 1-4 family residential properties (with a breakdown for FHA, VA, and conventional) and on new and unused commitments for various categories of mortgages, including those on 1-4 family homes and farm properties.

(4) Commercial bank report of consumer credit--information is collected monthly through the Federal Reserve Banks from a sample of about 770 commercial banks. The sample banks, which include over 300 of the largest bank holders of consumer instalment loans, account for about two-fifths of total consumer credit outstanding at all commercial banks. The reported information covers the amount of instalment loans made during the month and the total outstanding at the end of the month for automobiles (direct loans and purchased paper), mobile homes, other

consumer goods, home repair and modernization, and other personal expenditures, as well as the amounts of single-payment and credit card plan loans (with separate detail on loans made during the month for cash advances, retail purchases, and check credit and revolving credit plans) made and outstanding. In addition, the number of loans made during the month is obtained for all automobile and mobile home loans.

The only category of loans of special concern to the Committee for which no lending activity information is available from banks is loans to small businesses. FTC collects and publishes quarterly earnings and balance sheet information for manufacturing corporations which includes data on borrowing at banks, and these data are available by asset size of firm. However, this series would not be adequate for Committee purposes since the data exclude several sectors in which small businesses are relatively important (e.g., retail trade and services), are available with a considerable lag (around 10 weeks), and provide no information regarding the performance of individual banks. Thus, it seems desirable to institute direct bank reporting of loans outstanding to small business in the aggregate.

It is recommended that the existing panel of banks reporting interest rate information be requested to report once each quarter their total commercial and industrial loans outstanding to small businesses, as defined in the April 16 criteria, and to all businesses. Collecting both items would provide the basis for determining not only the magnitude and trend of bank lending to small businesses but also any changes in the small business share of total business loans outstanding. The availability of this information on a quarterly basis should be adequate since any changes by individual banks in the availability of credit to particular classes of customers would tend to affect the volume of loans outstanding in those categories relatively gradually.

Compiling information on loans to firms classified according to the Committee's criteria will involve an appreciable burden for banks, since they will have to identify their small business customers from information in their credit files and incorporate an appropriate code in their loan ledgers from which information on outstanding balances must be tabulated. But they need to identify their small-business customers in any event in order to comply with the Committee's interest-rate guidelines. To minimize reporting burden, consideration was given to requesting simply the reporting of all business loans outstanding below a certain loan-size cut-off, but this procedure would have serious deficiencies and is not recommended. Because some firms have borrowings

GERALD R. FORD LIBRARY

at more than one bank and individual banks sometimes make loans to the same firm from more than one department (e.g., instalment, receivables financing, and regular business loans), this approach would overstate the volume of lending to small business. In addition, the universe would change from quarter to quarter as outstanding loan balances of individual firms fluctuated above and below the cut-off.

We should also obtain quarterly information on loans outstanding to farmers, because the existing semi-annual cycle for reporting this information in the Call Report is inadequate. Since the bulk of loans outstanding to farmers at all except a few large banks in certain areas of the country are to borrowers that qualify as "small" according to the Committee's criteria, collection of information on total loans to farmers should provide a satisfactory monitoring base for the Committee's purposes.

It should be recognized, however, that with all the information now available and that we propose to collect, we would not be able to fulfill the commitment in paragraph 14 of the criteria. Periodic data on various types of loans outstanding at lending institutions can never tell us whether "legitimate credit needs" are being met. This would require a comprehensive survey of borrowers, not of lenders, and would involve the difficult problems of developing an acceptable definition of "legitimate credit needs" and an adequate measure of whether they are being met. Such a survey for present purposes is hardly feasible. Moreover, periodic information on bank loans outstanding to small businesses over a limited period cannot tell us whether the bank has made a major change in availability of credit to such businesses. One reason is that there is no feasible way of taking into account changes in loan demand. Also, there are large seasonal swings in loans to these types of borrowers, particularly at some individual banks. Thus, it would be necessary to have data for two or three years as a minimum before the underlying trend in outstandings could be appraised even roughly.

In short, the proposed report on outstanding loans to small businesses and farmers would serve mainly as a monitoring device to keep the 370 sample banks alert to their responsibilities and as an indicator that the Committee is attempting to carry out its program. Fortunately, the Congress has already provided considerable back-up machinery to assure that the legitimate credit needs of small business (SBA) and farmers (FCS) are being met, so the Committee need not feel that it is unduly exposed by paragraph 14 of the criteria.

One final point concerns the disposition of the compensating balance supplement to the Quarterly Interest Rate Survey which the System has been running since February 1972 at the request of the CID. This

GERALD R. FORD LIBRARY

supplement collects information on (1) the per cent of loans reported in the survey on which a compensating balance was required and (2) the average per cent of loan required as a compensating balance.

An analysis of the resultsof this survey by Stephen Slifer of the Banking Section confirms our earlier fears that compensating balance requirements are a fuzzy and sensitive area and they are not readily susceptible to quantitative measurement. Certainly the present survey appears to be yielding inconclusive and possibly misleading results. In view of these shortcomings, the lack of further Committee concern with rates and other terms on loans to large businesses (which is the main focus of the QIRS and the supplement), and the availability of the quarterly qualitative survey of lending practices at these same banks (which includes questions on compensating balances), it seems advisable to drop the supplement.

GERALD R. FORD LIBRARY

(Rev. 1/72) MADE DURING THE CALENDAR WEEK ENDED 1/15/72 Approval Expires 4/30/73

Read the instructions on the back of this form carefully before completing this side. Questions concerning the report should be directed to the Research Department of the Federal Reserve Bank. When there is no information to report for the current period, insert the word "none." Return one copy of the completed report to the Federal Reserve Bank within one week of the end of the week covered in the report, and retain one copy for your files.

Type of Loan	Stated interest rates charged (percent)			Method of interest charge (check one)			Compensating balances required		Number of loans made	
	Range of rates—lowest and highest		Most common rate	Add on	Discount	On outstanding balance	Percent of loans requiring compensating balance	Most common compensating balance (% of loan)	Number of loans made at the most common rate	Total number of loans made
	Low	High								
I. Small ($10,000 to $25,000) short-term (1 year or less maturity) noninstalment loans to businesses										
II. Farm production loans (1 year or less maturity): A. For feeder cattle operations										
B. For other farm production operating expenses										
III. Consumer instalment credit for: A. New automobiles (36-month)				ANNUAL PERCENTAGE RATE (TRUTH IN LENDING BASIS)						
B. Mobile homes (84-month)										
C. Other consumer goods (24-month)										
D. Other personal expenditures (12-month)										
E. Credit card plans										

Comment (if any) regarding recent interest rate developments at your bank: ______________

Name and Address of Bank

GERALD R. FORD LIBRARY

NAME AND TELEPHONE NUMBER (AND AREA CODE) OF PERSON TO WHOM QUESTIONS ABOUT THIS REPORT SHOULD BE DIRECTED

SIGNATURE AND TITLE OF PERSON AUTHORIZED TO SIGN THIS REPORT

INSTRUCTIONS

1. The types of loans listed on this form are intended to represent common types of loans likely to have rather standard characteristics as between borrowers and over periods of time.

For each of the types of loans listed, please report the required information only for loans made *directly* to customers and closed *during the week* indicated on the form. "Loans closed," for the purpose of this report, means formal loan agreements reached and/or notes signed, either new or renewals, regardless of whether any funds actually were disbursed during the week specified.

All loans secured by real estate and all loans purchased from dealers, other banks, or other sources should be excluded.

Loans to businesses, for the purpose of this report, *include* only noninstalment loans to domestic borrowers for commercial, industrial, service, or professional purposes. The definition for the purpose of this report *excludes* all accounts receivable loans.

2. *Interest rates* should be reported as percentages to two decimal places. Fractions should be shown as decimal equivalents, for example 6¼ percent should be shown as 6.25, 6 percent as 6.00, and 6½ percent as 6.50. Where loan agreements specify the "prime rate" or the "prime rate plus some percent," report the specific rate applicable. For example, if the rate charged is prime plus ½ percent and your bank's prevailing "prime rate" is 5½ percent, report 6.00 percent.

If the rate charged on credit card plans depends on the size of the outstanding balance, e.g., 18 percent on the first $500 and 12 percent on the remainder, report only the initial rate, i.e., 18.00. Ignore finance charges that do not recur each month.

In sections relating to the interest charge on consumer instalment credit, the rates that should be reported are the "truth-in-lending" rates shown on the loan documents as required by law.

3. The *"most common rate"* means the rate at which the largest dollar volume of loans in a particular type was made. If all loans were made at the same rate, that rate should be reported as the most common rate and "none" should be shown in the range of rates column. If a range of rates is reported, show the lowest rate first and the highest second. The most common rate must lie within the reported range.

4. *Only one method of interest charge* should be reported for each loan type. If more than one method of charge actually was employed on loans in a particular category, report the method applicable to the largest dollar volume of loans in that category. The information reported on the range of rates, the most common rate, and the number of loans made should apply only to those loans made that used the method of charge reported.

5. *"Compensating balances"* for the purpose of this report means deposit balances formally required in a loan agreement or by an informal understanding with a borrower. The fact that a borrower simply maintains a checking or savings account with the bank or that a loan is secured by a savings passbook or a certificate of deposit is not relevant for this purpose.

The "percentage of loans requiring a compensating balance" should be shown to the nearest whole percent, based on dollar volume of loans. It may be estimated by a person knowledgeable in the area. If compensating balances are required but there is no specific percentage on individual loans, footnote this fact in the space at the bottom of the form.

6. *Total number of loans made* should include all new loans and renewals of loans made during the week covered in the report. The number should include *only* those loans fitting the loan category described in the stub of the form and defined under instructions 1 and 4 above. If determination of exact numbers is not feasible, estimates may be reported. If estimates *are* reported, please indicate this.

GERALD R. FORD LIBRARY

June 5, 1973

Proposed new line to be added below double line at bottom of Form F.R. 835:

Memorandum: Small business prime rate _______%

Proposed new item 7 to be added to the Instructions for Form F.R. 835:

7. The "small business prime rate," as defined by the Committee on Interest and Dividends, is the best rate charged by a bank to its most credit-worthy local small business customers. A small business is any domestic--commercial, industrial, or agricultural--borrower whose total borrowings outstanding at any one time over the preceding 12 months (exclusive of long-term real estate mortgage debt) did not exceed $350,000 and whose assets do not exceed $1 million.

GERALD R. FORD LIBRARY

Form F.R. 835a

OMB No.
Approval expires

Quarterly Supplement to the Monthly Survey
on Interest Rates Charged on Selected Types of Loans
(July 1973)

Please report in item 1 below the dollar amount of outstanding loans to farmers (exclusive of loans secured by real estate), in item 2 the dollar amount of commercial and industrial loans outstanding to small-business customers, and in item 3 the total amount of commercial and industrial loans outstanding. For purposes of this supplement, loans to farmers are defined the same as for Schedule A, item 4 of the Call Report and commercial and industrial loans the same as for Schedule A, item 5. A small business, as defined by the Committee on Interest and Dividends, is a commercial or industrial borrower whose total borrowings outstanding at any one time over the preceding 12 months (exclusive of long-term real estate mortgage debt) did not exceed $350,000 and whose assets do not exceed $1 million.

	Amount outstanding on survey date
1. Loans to farmers	$____________
2. Loans to small businesses	$____________
3. Total commercial and industrial loans	$____________

GERALD R. FORD LIBRARY

Name and address of bank

Name and telephone number (including area code) of person to whom questions about this supplement should be directed.

Return to:

June 5, 1973

Signature and title of person authorized to sign this report.

Form F.R. 835a

OMB No.
Approval expires

Quarterly Supplement to the Monthly Survey
on Interest Rates Charged on Selected Types of Loans
(July 1973)

Please report in item 1 below the dollar amount of outstanding loans to farmers (exclusive of loans secured by real estate), in item 2 the dollar amount of commercial and industrial loans outstanding to small-business customers, and in item 3 the total amount of commercial and industrial loans outstanding. For purposes of this supplement, loans to farmers are defined the same as for Schedule A, item 4 of the Call Report and commercial and industrial loans the same as for Schedule A, item 5. A small business, as defined by the Committee on Interest and Dividends, is a commercial or industrial borrower whose total borrowings outstanding at any one time over the preceding 12 months (exclusive of long-term real estate mortgage debt) did not exceed $350,000 and whose assets do not exceed $1 million.

	Amount outstanding on survey date
1. Loans to farmers	$____________
2. Loans to small businesses	$____________
3. Total commercial and industrial loans	$____________

GERALD R. FORD LIBRARY

Name and address of bank

Name and telephone number (including area code) of person to whom questions about this supplement should be directed.

Return to:

June 5, 1973

Signature and title of person authorized to sign this report.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 16, 1973

To Chairman Burns

Subject:

From Mr. Melnicoff

DLM.

Governor Sheehan asked me to give you this note.

Our "subsidy" to employees in the Cafeteria has increased for this year to date over last year from 38.6% to 42.2% of costs. In July our net loss was 48.6% of total cost.* This figure may be distorted by inventory adjustments; however, there is no doubt that we have experienced a substantial increase in food costs.

We have increased prices this year, but we do not have a good comprehensive index of costs. For the first 5 or 6 months of the year we experienced an increase of about 4-1/2% in patronage, while sales increased by about 8%. This yields a rough measure of increase in our prices of about 4%. A list of the kind of the price increase we have made is attached (Attachment A).

Total expenditures on food was up well over 10% (unit costs probably up 6%) and payroll was up almost 14%. Although other operating costs declined, it is clear that total cafeteria costs are rising faster than our sales prices.

I am also attaching a sample of the kind of analysis we do from month to month.

Attachments

*The subsidy as running about $14,000 - $15,000 per month.

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ATTACHMENT A

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date: August 15, 1973

To: Mr. Melnicoff

Subject: FRB Food Price Increases

From: Walter W. Kreimann W.K.

We are putting in effect all of the increases listed below except Item Number 6 (coffee 10¢ to 15¢) which will be increased next week. Our vended coffee machines are also being increased to 15¢ in the near future.

No.	Item	Amount of Increase	From	To
1	All Vegetables	.05	.15	.20
2	Fresh Fruit Plate	.10	.65	.75
3	Gelatin Molded Salad	.05	.25	.30
4	Fruit and Cottage Cheese	.05	.35	.40
5	Combination Plate (Gelatin, Fruit & Cottage Cheese)	.05	.65	.70
6	Coffee	.05	.10	.15
	Sanka	.05	.10	.15
7	Pie and Cake	.05	.20	.25
8	Chef's Salad Bowl	.05	.45	.50
9	Large Green Salad	.05	.25	.30
10	Bacon	.05	.10	.15
11	All Sandwiches	.10		
12	Eggs	.05	.15	.20

Our Wholesale prices are continuing to rise rapidly so additional increases will be in order. We have alerted the Employees Committee to these increases. I will keep you advised.

GERALD R. FORD LIBRARY

Dayof. pay
Operating days.

Cafeteria Operations

I. Increase in Sales & Patrons

Sales

5 months 1973	$88,128.99
5 months 1972	81,762.96
7.79% Increase	$ 6,366.03

No. of Patrons (Total)

	This Year			Last Year		
	Break.	Lunch	Snack	Break.	Lunch	Snack
Jan	4,488	15,919	1,376	3,922	14,482	1,829
Feb	3,997	14,682	1,290	3,754	13,741	1,832
March	4,836	16,755	1,704	4,729	15,980	2,100
April	4,408	15,686	1,626	4,564	14,007	1,687
May	4,541	16,530	1,648	5,024	15,362	1,827
	22,270	79,572	7,644	21,993	73,572	9,275
		109,486				104,840

109,486 - 104,840 = 4,646 = 4.43% increase

II. Cost of Sales

1973 - 5 months	$52,207.94
1972 - 5 months	47,171.91
10.67% Increase	$ 5,036.03

III. Payroll

1973 - 5 months	$93,030.94
1972 - 5 months	81,641.02
13.95% Increase	$11,389.82

IV. Operating Expense

	1972	1973
All Other Costs	$ 5,831 (5.9%)	$ 6,384 (7.3%)
Salaries & Fringe Benefits	93,031 (94.1%)	81,641 (92.7%)
TOTAL	$98,862	$88,025

GERALD R. FORD LIBRARY

Summary

Sales increasing	7.79%
Patronage increasing	4.43%
Selling prices are increasing	
Cost of Sales (Food) increasing	10.67%
Payroll increasing	13.95%
All other operating costs decreasing	8.66%

Cost of food and payroll are rising faster than selling prices; offsetting the results of increased patronage and increased selling prices to produce a still greater net loss.

GERALD R. FORD LIBRARY

ACR 4 FEDERAL RESERVE BOARD REPORT DATE: 08/09/73

CAFETERIA OPERATIONS FOR JUL, 73

TOTAL PATRONS	OPERATING DAYS	DAILY AVERAGE
20,916	21	996

ACCOUNT NUMBER	DESCRIPTION		THIS MONTH	LAST MONTH	YEAR TO DATE THIS YEAR	YEAR TO DATE LAST YEAR
	SALES					
15100070000000	BREAKFAST	4,147	1,564.93	1,526.81	11,208.07	11,468.36
15100071000000	LUNCH	15,374	14,092.43	15,031.49	104,790.78	96,429.38
15100072000000	SNACK BAR	1,395	468.08	577.52	3,646.30	3,786.07
15100074000000	EMPLOYEE MEALS		344.11	329.62	2,325.48	2,068.28
15100076000000	MISCELLANEOUS		40.40		133.75	187.38
	TOTAL SALES		16,509.95	17,465.44	122,104.38	113,939.47
15100051000000	COST OF SALES		10,537.47	10,094.91	72,840.32	66,413.31
	GROSS PROFIT		5,972.48	7,370.53	49,264.06	47,526.16
15100079000000	OTHER INCOME		174.42	199.88	1,376.52	2,273.31
	TOTAL GROSS PROFIT		6,146.90	7,570.41	50,640.58	49,799.47
	COST OF SALES/TOTAL SALES %		63.82	57.79	59.65	58.28
	OPERATING EXPENSES					
15100080000000	SALARIES		19,066.12	17,247.04	121,625.45	104,969.20
15100081000000	RETIREMENT & THRIFT		1,356.52	1,275.98	9,133.52	7,369.66
15100081500000	LIFE & HEALTH INSURANCE		246.18	225.92	1,689.73	1,523.55
	TOTAL PAYROLL		20,668.82	18,748.94	132,448.70	113,862.41
15100082000000	LAUNDRY		423.59	510.61	3,138.24	2,982.29
15100083000000	GAS		35.87	26.04	251.74	276.51
	TOTAL SERVICE CHARGES		459.46	536.65	3,389.98	3,258.80
15100053000000	CLEANING & PAPER SUPPLIES		475.75	538.23	3,265.19	3,148.33
15100088000000	UNIFORMS				134.10	
15100089000000	SUNDRY		84.80	84.00	428.80	362.20
	TOTAL SUPPLIES		560.55	622.23	3,828.09	3,510.53
15100085000000	REPAIRS & MAINTENANCE		228.94	30.00	377.36	1,324.54
15100087000000	UTENSILS, CHINA & SILVER				673.84	1,037.60
	TOTAL REPAIRS		228.94	30.00	1,051.20	2,362.14
	TOTAL OPERATING EXPENSE		21,917.77	19,937.82	140,717.97	122,993.88
	NET LOSS		15,770.87	12,367.41	90,077.39	73,194.41
	RECAPITULATION					
	TOTAL RECEIPTS		16,684.37	17,665.32	123,480.90	116,212.78
	COST OF SALES		10,537.47	10,094.91	72,840.32	66,413.31
	TOTAL OPERATING EXPENSES		21,917.77	19,937.82	140,717.97	122,993.88
	TOTAL COSTS		32,455.24	30,032.73	213,558.29	189,407.19
	NET LOSS		15,770.87	12,367.41	90,077.39	73,194.41
	NET LOSS/TOTAL COSTS %		48.59	41.17	42.17	38.64

NUMBER OF EMPLOYEES ON PAYROLL AT END OF MONTH: 32

GERALD R. FORD LIBRARY

WITHDRAWAL SHEET (PRESIDENTIAL LIBRARIES)

FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
Memo	To Board Members From David Melnicoff, Subject: Financial Condition of a Bank (3 pgs)	4/27/1977	B

File Location:

Arthur Burns Papers, Box C17, "Melnicoff, David C." -- JPS / 3/13/2013

RESTRICTION CODES

(A) Closed by applicable Executive order governing access to national security information.
(B) Closed by statute or by the agency which originated the document.
(C) Closed in accordance with restrictions contained in the donor's deed of gift.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 29, 1973

To Chairman Burns

Subject:

From David C. Melnicoff

Over the last year and a half, total cost to the Board for work related to the President's New Economic Program and its successor activities was over $506,000. This amount is included within departmental expenditures, but pulled out as a memorandum item in our budget statements.

The amount charged for International Finance activities appears large; but this is the figure which the Division feels is related to work undertaken on behalf of the program announced by the President in 1971. I do not think it is unfair to segregate it up to this time.

Attachment

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 23, 1973

To Chairman Burns
VIA: Mr. Melnicoff
From John Kakalec

Subject: Status Report - Cost of President's New Economic Program to Board

JK

The attached table provides a summary of expenses incurred by the Board on behalf of the President's New Economic Program (NEP) and the Committee on Interest and Dividends (CID) from late 1971 through the first quarter of 1973. The total cost related to NEP was over $506,000 representing 5,900 man-days, of which CID represents over 2,700 man-days and $280,000. Out of pocket expenses for CID amounted to $8,200. No new positions were created specifically to deal with NEP, although during the employment freeze in 1972, some Divisions were permitted to fill vacancies because of the impact of NEP.

The major contributors to the NEP effort include:

<u>BOARD MEMBERS</u> $ 65,686

- Public relations on behalf of CID and direction of System compliance with salary and wage provisions.

<u>EXECUTIVE DIRECTOR</u> $115,317

- Administration of the Committee on Interest and Dividends.

<u>RESEARCH AND STATISTICS</u> $119,726

- Development of position papers during early stages. Developing and monitoring programs to obtain information on interest rates being charged on various categories of loans of special interest to the CID. Analysis of data re: prime rate and developing and interpreting criteria for setting up a two tier prime rate.

<u>INTERNATIONAL FINANCE</u> $161,349

- Direct support of the Chairman in handling the international monetary situation. Reviewing and analyzing

GERALD R. FORD LIBRARY

INTERNATIONAL FINANCE (Cont'd)

current operations, export and trade data, balance of payments data, impact of devaluations, etc., resulting from the Smithsonian Agreement. Analyzing impact of the Smithsonian Agreement, exchange rate adjustment and Euro-dollar movements from the European standpoint.

DIVISION OF DATA PROCESSING $ 20,265

- Development of computer programs to provide tabulation of survey data for Committee on Interest and Dividends.

Attachment

GERALD R. FORD LIBRARY

Attachment

SUMMARY REPORT

New Economic Program (Including CID)

	Man Days	Salaries & Fringe Benefits	Out of Pocket Expenses	Total Costs
1971	1,316	$115,155	$2,305	$117,460
1972	3,823	291,556	872	292,428
1973 1st Qtr.	780	91,144	5,013	96,157
TOTAL	5,919	$497,855	$8,190	$506,045

NEP by Division (Excluding CID)

	1971	1972	1st Qtr 1973	Total
Board Members	$ 10,821	$ 44,233	$10,632	$ 65,686
Executive Director	20,304	70,778	24,235	115,317
Office of the Secretary	242	-0-	-0-	242
Legal	583	3,492	1,868	5,943
Research & Statistics	38,575	65,401	15,750	119,726
International Finance	33,579	93,395	34,375	161,349
Supervision & Regulation	-0-	-0-	-0-	-0-
FR Bank Operations	-0-	-0-	-0-	-0-
Personnel Administration	1,381	-0-	-0-	1,381
Administrative Services	442	404	1,638	2,484
Office of the Controller	5,462	-0-	-0-	5,462
Data Processing	3,766	13,853	2,646	20,265
TOTAL	$115,155	$291,556	$91,144	$497,855

Committee on Interest and Dividends

	Man Days	Salaries & Fringe Benefits	Out of Pocket Expenses	Total Costs
1971	566	$ 60,539	$2,305	$ 62,844
1972	1,730	160,871	872	161,743
1973 1st Qtr.	427	50,042	5,013	55,055
TOTAL	2,723	$271,452	$8,190	$279,642

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 31, 1972

To Chairman Burns

Subject: Your request for a paper on the seasonal borrowing privilege

From David C. Melnicoff

The attached paper on the proposed seasonal borrowing privilege was prepared for you by Emil Melichar, who is the Board's senior economist specializing in agricultural credits. Mr. Melichar worked on the development of the proposal, has made evaluations of its impact on rural banks, and has been following bank and public reaction closely.

Attachment

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 20, 1972

To Chairman Burns

From Division of Research and Statistics (Mr. Melichar)

Subject: Proposed seasonal borrowing privilege for member banks.

This memorandum addresses questions you raised with Mr. Melnicoff concerning the proposed seasonal borrowing privilege.

Current interest in the privilege.

During the past year, rural bankers have voiced vigorous support for the proposed changes in the discount mechanism. The Agricultural Credit Task Force, a group of bankers appointed by The American Bankers Association (ABA) in 1971 to study rural banking problems, reported to the 20th Annual ABA National Agricultural and Rural Affairs Conference (Kansas City, November 1971) that "the proposals which were brought forth in the Fed's study several years ago...should be implemented."

In a talk to the North Carolina Bankers Association's Farm Credit Conference (Raleigh, February 1972), Mr. Thomas R. Smith (President, First National Bank, Perry, Iowa), Chairman of the ABA Agricultural and Rural Affairs Committee, was quoted as saying "other lenders--the Farmers Home Administration and the Farm Credit System for example--are concerned about rural development. But our own kinfolk--the Fed--is sitting there and is hard to move. Money is needed in rural areas, and now's the time to implement the proposals." In writing to Mr. Roby Sloan of the Federal Reserve Bank of Chicago, Mr. Smith stated "I would appreciate your expressing my concern for

GERALD R. FORD LIBRARY

the inaction on this program wherever it might do some good."

Subsequently, at the 1972 ABA Conference (White Sulphur Springs, March 1972), on the recommendation of its Agricultural Credit Task Force, the ABA Board of Directors adopted a resolution recommending implementation of the discount proposals, stressing that the changes would be "particularly important and significant in agricultural communities. Commercial banks serving such communities would be able to provide a more ample and stable flow of funds to farms and agricultural enterprises if these changes were enacted." While the resolution (a copy is attached) did not discuss any individual proposal, the expected outcome it described probably depends on adoption of an effective seasonal privilege.

In the March 16, 1972 American Banker, Harold K. Street, in his "Rural Development" column, noted that "bankers and others said the seasonal privilege would go a long way toward meeting the needs of banks that have wide seasonal variations." The full article is attached.

Most recently within the System, the proposed seasonal privilege has been one of several mechanisms examined by the Ad Hoc Committee appointed by the Board in 1970 to study rural banking problems (committee members are Mr. Clay, chairman; Mr. Kimbrel, and Governor Mitchell). A tentative report drafted at the committee meeting of June 15 states that the seasonal borrowing privilege will provide significant assistance to smaller member banks with large

GERALD R. FORD LIBRARY

seasonal outflows, and that it should be implemented promptly since it entails only a small and gradual impact on the degree of restraint being maintained by prevailing monetary policy.

Need for a separate borrowing privilege.

Individual bank adjustments necessitated by seasonal fund flows have several characteristics that differ materially from most other adjustments that result in demand for Federal Reserve credit. In addition to being, by definition, recurring flows that are largely predictable from past experience, seasonal outflows at some individual banks are quite large relative to the banks' resources, and they are often of relatively long duration--most commonly corresponding to the length of crop production seasons, perhaps 4 to 6 months. Thus at the smaller rural banks in crop production areas, which comprise a majority of the banks at which severe seasonality exists, banking strategies and operations are dominated by the seasonal flows.1/ To be effective, a seasonal lending program at the discount window must be adapted to the banking considerations that derive from this highly seasonal environment.

1/ The Board staff study of seasonal banking flows presented the following example of a severe rural seasonal and how it is now handled by banks. At a "composite" small (deposits of $3 million) rural (farm loans comprising 75 per cent of total loans) bank in Nebraska, deposits fell by 23 per cent between January and July, while loans simultaneously rose by an amount equal to 25 per cent of the December level of deposits. To meet this two-edged fund outflow totaling 48 per cent of deposits, the bank sold U.S. Government securities amounting to 37 per cent of the December deposit level, and drew down correspondent balances equal to another 6 per cent of deposits. The bank's loan-deposit ratio oscillated annually between 40 per cent in December and 75 per cent in July.

GERALD R. FORD LIBRARY

Typically, a small bank now copes with a highly seasonal environment largely by maintaining substantial liquidity in its own resources. At rural banks, the inflow of funds each fall is stored in liquid form to meet the next year's certain spring outflow. Consequently, a significant proportion of the banking resources of such communities is effectively utilized for only a fraction of the year. In these circumstances, a Federal Reserve seasonal lending program can help free a portion of these underutilized funds for other lending. But given the essential economic role that the seasonal loans usually play that lending program, to be most effective, must assure bankers of certain availability of a predetermined amount of funds at the required time and for the required duration, as planned in prior negotiations, regardless of subsequent changes in the stance of national monetary policy. It seems desirable to draw a clear line between credit provided on these terms and that provided for other types of adjustments. A seasonal borrowing privilege achieves this separation.

Anticipated use of the privilege.

It is logical to believe that banks will utilize the seasonal privilege if and as they experience or develop other lending opportunities for the funds that can thereby be released from the seasonal treadmill. Since many of the banks with large relative seasonal variation are rural banks, typical alternative lending

GERALD R. FORD LIBRARY

opportunities may consist of--

a) nonfarm development loans--a pressing need in many rural communities as judged by rising public pressure for expanded Federal credit programs for rural areas;

b) term loans to farmers to finance increased investment in livestock inventories and machinery stocks--the two fastest-growing areas of farm capital and credit demands (the faster growth of farm loans at cooperative production credit associations (PCA's) than at banks may be indicative of latent farm lending opportunities for banks);

c) latent seasonal loan demands (for instance, the much greater seasonal variation in non-real-estate farm loan volume at PCA's than at banks may be indicative of additional seasonal farm lending opportunities for banks).

Thus it is logical to expect that actual takedowns of funds under a seasonal privilege would at first be limited to a relatively small proportion of maximum eligibility and then expand over time as these alternative lending opportunities arise or become evident to bankers, and as bankers develop experience with and confidence in the reliability of the Federal Reserve as a source of preplanned seasonal funds. Maximum eligibility as of 1970, under the current draft proposal, has been calculated by separately processing 1968-70 data for each member bank, using the Census Method II monthly seasonal adjustment program. If each bank borrowed the maximum amounts indicated

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for it by this generalized computational procedure, national daily average borrowing would range from about $200 million in December and January to about $1 billion in the summer months, with the yearly average at $700 million. Actual borrowing would be significantly below these maximum amounts because some of the computer-calculated "seasonals" would not be allowed upon review of the circumstances under which they arose, and because of the lag in utilization already noted and the usual probabilities that some bankers will never take advantage of such a privilege and that others will not use it fully.

GERALD R. FORD LIBRARY

THE AMERICAN BANKERS ASSOCIATION NEWS
COMMUNICATIONS DEPARTMENT • 1120 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20036

CONTACT: Tom Mason
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IMMEDIATE RELEASE
(72)

ABA Resolution on revision of the Discount Mechanism

White Sulphur Springs, West Virginia -- The American Bankers Association recommended today that the Federal Reserve System implement proposed changes in its lending policies.

The changes were proposed in 1968 by a special committee of the Reserve System. They would permit easier access by the Reserve System's banks to Fed lending facilities -- facilities known as the "discount window."

The proposals were not implemented earlier because of tight monetary conditions, the ABA said. But, it added that, "in view of the fact that such monetary conditions do not presently exist, now seems to be an appropriate time for implementing these proposed revisions in discount policy."

The ABA recommendation was set forth in a resolution adopted by the association's Board of Directors, meeting here.

Implementation of the proposed changes, the ABA said, "would help to revitalize the discount mechanism and improve the allocation of credit in the economy."

The committee's proposed program would provide:

- a "basic borrowing privilege" extending access to the discount window;
- a "seasonal borrowing privilege" increasing access by banks with large seasonal variations in loan demands;
- a "supplemental borrowing privilege" providing additional access by banks facing unusual circumstances;
- a policy incouraging more flexible discount rates.

The ABA resolution said that improvements resulting from the changes would be "particularly important and significant in agricultural communities.

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(More)

"Commercial banks serving such communities would be able to provide a more ample and stable flow of funds to farms and agricultural enterprises if these changes were enacted.

"The flow of funds into other critical areas would also be improved by these measures.

"For these reasons, the American Bankers Association recommends that the Federal Reserve System act at the earliest opportunity to implement its special committee's proposals for reform of the discount mechanism."

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GERALD R. FORD LIBRARY

RURAL DEVELOPMENT

American Banker 3-16-72

Vantage Point

Outlook Better for Improved Flow of Fed Farm-Loan Funds

By HAROLD K. STREET

WASHINGTON. — The Federal Reserve System is being urged to make its funds more readily available to rural banks to meet their farm credit needs.

It is being asked to do this by implementing recommendations of a study, completed in 1968, that advocated changes expected to make it easier for member banks to borrow from the Fed.

The pressure on the Fed to make the changes is not as great now as it was shortly after the study was completed. But the chances that the Fed will implement its recommendations are better now than they were then.

The committee that conducted the study recommended that the Fed revise the operations of its discount window through which it loans money to member banks.

It called for the establishment of a basic borrowing privilege through which each member bank could borrow for any purpose up to a specified amount for a specified number of weeks in a year; and a seasonal borrowing privilege through which a bank could borrow for longer periods to meet seasonal needs.

The recommendations were greeted warmly by agricultural bankers and others involved in farm credit. The changes, they agreed, would not solve problems of getting funds into rural areas to meet intermediate and long-term capital needs.

But, the bankers and others said, the seasonal privilege would go a long way toward meeting the needs of banks that have wide seasonal variations in loans and deposits — for example, heavy demand for loans in the spring when crops are planted and a heavy inflow of funds after harvest.

The Fed's original timetable called for implementing the stury recommendations early in 1969. This was not done, largely because of the tight money conditions that existed then. Money no longer is tight, but the changes still have not been implemented.

Predictably, the Fed came under heavy pressure to implement the changes from bankers who needed money during the credit crunch. Just as predictably, the pressure became less intense when money became less tight.

Early this month, George W. Mitchell, a member of the Fed board of governors and chairman of the committee that headed the study, expressed the hope that the basic and seasonal borrowing privileges will be put into effect soon.

At the same time, Thomas R. Smith, chairman of the Agricultural and Rural Affairs Division of the American Bankers Assoication, called upon the Fed to take action now. Mr. Smith, the president of the $14.5 million-deposit First National Bank of Perry, Iowa, also urged other bankers to do likewise.

An ABA Agricultural Credit Task Force also is expected to recommend that the Fed implement the discount window changes. The task force, which has been looking into various ways of getting more funds into rural areas, is expected to report its findings this spring.

Banks that are members of the Federal Reserve System now have access to the discount window at Federal Reserve Banks. In fact, a Fed spokesman explained this week, the term discount now is somewhat of a misnomer. The Fed recently streamlined the procedure so that a member bank now can arrange to have an advance credited to its reserve account without actually discounting paper through the reserve bank.

But, Mr .Mitchell observed in a speech to a farm forum in Minneapolis, "over the postwar years, a majority of rural member banks had not used the discount window at all, and others only infrequently."

"Many rural bankers got the impression that discounting was a 'forbidden fruit,'" Mr. Mitchell continued. "This impression was fostered because the Federal Reserve did not clearly define the difference between appropriate and inapproriate use of reserve credit."

The basic borrowing privilege would provide this clear definition. Under it, in Mr. Mitchell's words, "a bank could, with no questions asked, borrow up to a specified amount for a specified number of weeks in each year.

"Thus the extent to which Federal Reserve borrowing could be used as a

GERALD R. FORD LIBRARY

American Banker 3-16-72

ready source of short-term adjustment credit would be known."

The seasonal borrowing privilege would be less automatic. According to a Fed spokesman, it would have to be negotiated with the reserve bank by the member rural banker, who would have to show a seasonal pattern of need for loan funds.

It could be arranged for up to 9 months. Then, the spokesman said, it would become a line of credit which the rural bank could draw on as needed.

As Mr. Mitchell described it, "under the seasonal borrowing privilege, banks could arrange for Federal Reserve funds to accommodate all of their seasonal outflow exceeding a certain percentage — perhaps 5 to 10% — of their average level of deposits.

"Such generous access to Federal Reserve credit, we believed, was justified by the demonstrated ability of small rural banks to obtain seasonal funds in money markets.

"Given the assured seasonal access to Federal Reserve credit, these banks could begin to make longer term loans for both farm and nonfarm purposes, using some of the funds that presently must be kept in liquid instruments in order to be available for the seasonal demands," Mr. Mitchell added.

Since the proposals were made, according to Mr. Mitchell, the Fed staff "has been continuously working to refine the proposal especially the rules and administration of the seasonal privilege."

The staff also has been keeping track of how the seasonal privilege would be working if it were in effect now. It has concluded that while the change would not make a large impact on total farm credit needs, it would provide a large share — possibly most — of the funds needed by banks that have big seasonal swings in supply and demand of money.

In a prelimanary report of the findings of the ABA task force during the ABA's 20th National Agricultural and Rural Affairs Conference in Kansas City in November, the chairman of the task force subcommittee on Banking Sources of Funds, Robert E. Hamilton, noted that his subcommittee agreed that the availability of the discount window would help in a limited way with seasonal and emergency credit needs.

But Mr. Hamilton, who is vice chairman of the $506.7 million-deposit Central National Bank in Chicago, added, it "would in no way help to solve the major long-term problem of banks to provide capital and development type credit to our agricultural borrowers."

Mr. Smith spoke of the need for the Fed to implement the discount window revision proposals during a talk to the North Carolina Bankers Association's 18th annual Farm Credit Conference in Raleigh.

The Iowa banker realizes that "about the time the Fed was set to implement its proposals, we got into tight money." But, Mr. Smith said this week, "there's no reason they can't be implemented now.

"Other lenders — the Farmers Home Administration and Farm Credit System for example — are concerned about rural development," Mr. Smith added. "But our own kinfolk — the Fed — is sitting there and is hard to move. Money is needed in rural areas, and now's the time to implement the proposals."

"It is not surprising that I, as the chairman of the original study committee, regret that the Federal Reserve has not yet fully implemented the committee's recommendations," Mr. Mitchell said in Minneapolis.

"One difficulty has been that liberalized access to the discount window should be introduced during a time of relative neutrality in monetary policy, and such times have been scarce and brief since 1968."

According to Mr. Mitchell, "the Federal Reserve is a conservative institution which usually moves deliberately after full study and consideration.

"But I do not think it would be fair to say we would deliberately study a problem until it becomes extinct, and for that reason I can hope we will soon be doing our bit to improve the ability of the private sector to finance rural economies and agriculture."

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 1, 1972

To Chairman Burns

Subject: Poll of Mutual Savings Bank Representatives

From David C. Melnicoff

At a March 1 meeting of representatives of the National Association of Mutual Savings Banks with members of the Board of Governors, 48 heads of institutions were polled on recent mortgage rates and trends.

Of 48 savings banks represented, half had a current typical rate of 7-1/4 per cent on single-family home mortgages. The bulk of the rates rangedfrom 7 to 7-1/2 per cent. Typically, current rates were 1/2 to 3/4 per cent lower than those prevailing in January 1971. In some States, the decline since January 1971 has been 1 per cent and above.

The details of the poll are as follows:

CURRENT TRENDS ON TYPICAL CONVENTIONAL ONE-FAMILY RESIDENTIAL MORTGAGES AT 48 MUTUAL SAVINGS BANKS IN 17 STATES

Rates	Number of Banks
8 %	1
7-3/4	0
7-1/2	15
7-1/4	24
7	7
6-3/4	1
TOTAL	48

DECLINES IN TYPICAL MORTGAGE RATES AT MUTUAL SAVINGS BANKS SINCE JANUARY 1971

Decline in Rate	Number of Banks
1-1/4%	6
1	4
3/4	12
1/2	13
1/4	7
No apparent change	6*
TOTAL	48

* Included in the 6 "no change" banks are some in States in which usury ceilings prevented a rise in interest rates to market levels during periods of credit stringency.

GERALD R. FORD LIBRARY

DCMelnicoff
10-26-71

Phase II -- Bullock speech notes.

GERALD R. FORD LIBRARY

As we move into what has become known as "Phase II" of the President's Stabilization Program (formerly the New Economic Policy) there is wide spread uncertainty as to its intent and probable results. Doubt about the latter is understandable, for a program whose success depends so much on public support and (psychological) response. The former (the intent) should by now be clear.

The proximate goal of cutting the rate of price advances in half (COLC says "to 2 to 3 per cent per year by the end of 1972 and to continue reduction thereafter") is for the purpose of establishing an environment in which market forces -- freed from excessive inflationary expectations -- can be effective in promoting a satisfactory rate of economic growth with stability.1/

1/ "Stability is not likely to mean a zero increase in the consumers' price and other indexes ordinarily used to measure it. These indexes will show gains which reflect the cost of higher quality -- including environmental quality -- which will be required (though not always appreciated by individual facilities) in the years ahead. Stability will, however, require that self-correcting forces be present and working.

The Program does not seek to plan every step of the business recovery or the inflationary slow-down through direct allocation of resources or through detailed manipulation of prices, wages, profits, interest rates and dividends. Rather, <u>it seeks to create the kind of limits competitive conditions might otherwise establish</u>. In all too many segments of the economy groups with great market power -- big unions, big corporations, and big municipalities, professional interest groups -- have not been subject to the market checks and balances necessary for reasonable stability.[2/]

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2/ As evidence of a new situation, unlike classic descriptions of the business cycle, cite behavior of wage rates in 1970-71. Business slowdown and higher unemployment failed to slow the rate of advance of wage rates.

Conjecture (sometimes stated with great authority) that the ration has embarked on a permanent control path leading to something like Galbraith's "disequilibrium system" or "Industrial State" should not be accepted as fact. There may well be some institutional residue from this current effort; we may, in fact, need the countervailing power of a public-interest labor court, for instance. But the President's recent change in tactics does not signal the inevitability of continuing intervention on a major scale, and this is certainly not the President's intention. We should not give up on efforts to make our financial and economic institutions responsive to social objectives.

Evidence:

1. The nature of the Stabilization Program's administration.

   Loose structure providing for shifting, progmatic standards. No large-scale beaurocracy. Room for voluntary effort which allows market power to show through.[3/]

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3/ Medical analogy: physician often foregoes use of powerful broad spectrum anti-biotics until precise diagnosis can be made -- even at considerable risk.

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2. The conception of the role of interest rates. If evidence under (1) precludes obvious long-term direct controls, perhaps there is an intention to incapacitate free markets in a more subtle way -- e.g., through control of interest rates. Language of the executive order and the proposed Stabilization Act (as amended) show this is not the intent. Executive Order says:

"This (Interest and Dividend) Committee shall, subject to review by the (COL) Council, formulate and execute a program for obtaining voluntary restraints on interest rates and dividends."

Language of the proposed Stabilization Act, if it is necessary to bring it to bear, authorizes President issue orders "to stabilize interest rates and corporate dividends and similar transfers at levels consonant with orderly economic growth."

What does this language mean?

1. This is to be a voluntary program, providing for flexibility and giving the market freedom to adjust on areas of competition;
2. The Committee will maintain close surveillance of the entire structure of rates, and will exercise its influence where downside stickiness developes;
3. Monetary policy will be guided by the needs of the entire economy, including the need for long-term price level stability. The Federal Reserve System -- not the Committee -- will determine

policy in accordance with the Federal Reserve Act. Neither the Committee nor the System will be committed to any particular ceilings for rates; and the System need not support any particular level of the structure of rates.

There is objection to this concept by some members of Congress who have long expressed a Populist view of the role of interest. And it is hardly surprising that their voices find sympathetic ears. The 8-1/2 per cent peak in interest rates for high grade corporate bonds reached in 1970 was virtually unprecedented in modern times and was dangerously high in comparison to earings. Similar mortgage rates added thousands of dollars to the price paid for a home over the life of the mortgage.

High long-term rates persisted well into 1971, despite a sharp drop in short-term rates. The cause of this in part, was undoubtedly the same inflationary expectations -- a 5 or 6 per cent annual increase in prices -- that compelled labor to ask now for tomorrow's gains. Over a long period of rapidly rising prices, accompanies by increasing economic sophistication, and "inflation premium" has been built into the structure of interest rates. This must be squeezed out, and the way to do it is to

GERALD R. FORD LIBRARY

break down the expectation that prices will continue to rise rapidly.

I believe that the announcement of the President's Stabilization policy and the apparent success of the "freeze" has begun to give the public and business community confidence in our ability to control inflation. Both short and long-term interest rates have declined significantly since mid-August in the face of stronger business conditions. The inflation premium may be eroding.

In its first substantive statement, the Committee on Interest and Dividends stated, on October 20:

"Market rates of interest have declined in recent weeks in part because lenders no longer require as large an inflationary premium as they did earlier. The Committee anticipates that other interest rates will follow this pattern in the months ahead." (The prime rate already has." The Committee will focus mainly on some of the "sticky" rates in the near future, including mortgage rates, in an effort to nudge them into following the market promptly.

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The Committee cannot predict interest rate levels in the future, as the inflation premiums disappears, as the business recovery quickens. In its statement, the Committee points out, "There may be fluctuations in the level and structure of rates from time to time, reflecting changes in the demand for and supply of funds."

Presumably, there will be upward pressure on interest rates as the economy approaches full use of its resources some months hence. The surest way to rekindle inflationary expectations would be to attempt to hold market interest rates at some fixed "low" level by pouring reserve funds into the banking system. History -- as well as theory -- demonstrates that this is counter-productive. From 1942 until 1951 the Federal Reserve was "an engine of inflation," buying Government securities at fixed prices and creating massive amounts of liquid funds which flooded the markets for goods as soon as wartime controls were relaxed. The wholesale price level rose about 6.3 per cent per annum from 1946 to 1952. (1965 to 1971 ... about 2.8 per cent per annum)

Holding particular "consumer" interest rates at fixed levels does not help those it is intended to benefit either.

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(1) Many times in recent years, FHA mortgage ceilings have shunted credit away from the housing market. The payment of "points" by the seller has distorted transactions where credit is forced through despite ceilings.

(2) State usury ceilings have often stopped the flow of funds into housing (e.g., New Jersey at 7 per cent in 1969) and into consumer credit as well. In the state of Oregon, for instance, certain types of sales credit simply are not available to consumers.4/

4/ The administrative cost element of the "interest" rate for such things as credit cards is very high. A 12 per cent ceiling in Oregon, enacted in November 1968, forced curtailment of such credit.
Source: {Graduate School of Bus. Admin. Washington State Univ. Guy Gordon, et al. (1971) "The Impact of a Consumer Credit Interest Limitation Law; Wash. State Initiative 245"

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(3) Regulation Q governing interest on time deposits of commercial banks and savings institutions, though useful for some purposes, led to significant and upsetting "disintermediation" in 1966 and again in 1969.

(4) Another type of interest ceiling, a contractual ceiling rate on insurance company policy loans has, on occasion (again in 1966 and 1969) led to a near run on insurance company cash. This has had important repercussions in the mortgage credit market for a short time, leading to

unsettling discount annuities and mortgage commitments.

Will the President's stabilization program, built on the premises I have indicated, be successful? I believe ~~XX~~ there is good reason for optimism. We are moving in the right direction, but no one can say for sure, and this uncertainty is reflected in the stock market. (I cannot believe that the restraints on the dividends thus far announced can be causing a malaise that is affecting investors. It is something much deeper than this.) It is significant to me that the bond market, and the market for sophisticated buyers, is strong and that net offshore purchases of U.S. common stocks are beginning to show up on the plus side. It is apparently the small investor who is now showing a lack of confidence that is hurting the market and gives it its pessimestic tone. This is most dramatically revealed in the record of mutual fund sales and redemptions. During September, mutual fund net redemptions hit a record of $166 million, making that month the fourth of the last five which drained cash from the funds.

These remarks are not intended as having any substantive comment on the stock market and its future level, but rather as some indication that some degree of firmness and some favorable response is necessary to establish the creditability of the stabilization program's intentions and its chances of success. The smart money seems to be betting on success.

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