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Willis Alexander



THE AMERICAN BANKERS ASSOCIATION

SPEECH HIGHLIGHTS

Housing Finance and the Financial Institutions Act of 1973

Housing faces serious problems again this year, as it has in the past and will again in the future in periods of inflation and rapidly rising interest rates -- unless the mechanism for encouraging flows of funds into the residential mortgage market is improved. The program outlined in the Financial Institutions Act would be more efficient in generating such flows.

Of course, the best way to help housing is through the establishment and maintenance of a stable economy. We have not reached that millenium yet, so we must consider the alternatives.

The best alternative can be identified through a review of the operations of our economic system -- and a recognition that housing is only one part of a whole. Housing must compete for funds in the money market with all other sectors of the economy. If we want to ensure that funds are available for housing, we must take that competition into consideration.

The Financial Institutions Act looks at housing finance realistically as a part of the general money market. It seeks to generate funds for housing from the entire market, rather than from one specialized, restricted area. When the market does not provide a large enough flow of funds, it seeks to generate additional money by inducements extended to all, rather than to a single source of funds. This would provide a steadier, more reliable flow of funds than the present system.

The FIA recognizes the fact that the primary competition for funds is not between banks and thrift institutions. It is between regulated financial institutions and the unregulated portion of the money market. The FIA attempts to broaden the base for housing finance by offering an incentive -- a tax credit -- to all financial institutions to invest in it.

Such a system of incentives can provide any desired flow funds by adjusting the size of the incentive offered. It would free the housing industry from an unfortunate dependency on one type of financial institution for long-term mortgage funds -- a dependency that makes housing excessively sensitive to cyclical fluctuations in interest rates.

There are other actions that would help enhance housing's ability to compete for funds. One would be the removal of all usury ceilings imposed by state laws, an action similar to the removal of FHA and VA mortgage rate ceilings. Another would be the introduction of variable rate mortgages -- that is, mortgages whose interest rates varied with interest rates in the general money market. Finally, there is a need for a continued and perhaps more active secondary market for mortgages.



HOUSING FINANCE AND THE FINANCIAL INSTITUTIONS ACT OF 1973

Remarks by
Rex J. Morthland
President
American Bankers Association

Before the
National Association of Home Builders
Houston, Texas
January 21, 1974



No one here can be unaware that housing faces serious problems again this year. In fact, those problems are shared by the entire economy, particularly in view of the uncertain energy situation. I heard someone say this morning that if Moses came down off Mount Sinai today, the tablets he would bring would be two aspirin.

These problems may permeate the entire economy -- but few would deny they strike particularly hard at the housing industry. Construction equipment is idled by the energy shortage. Houses stand incomplete because of shortages in vital supplies. And perhaps most important, you're running up against a shortage of money -- again. I'm reminded of the Bill Mauldin cartoon of two G.I.'s sitting in a foxhole. As bombs go off around their heads, G.I. Joe says to his buddy, "Th' hell this ain't th' most important hole in th' world. I'm in it."

Housing does face serious problems again this year, as it has in the past. And it will again in the future -- unless the mechanism for encouraging flows of funds into the residential mortgage market is improved. I believe the program outlined in the Financial Institutions Act of 1973 would be more efficient in generating such flows. Let me explain why.

At the outset, we must recognize one simple fact that seems to have been overlooked by most people: Since 1948, housing has been considered a major priority in our nation -- and we've moved heaven and earth in an effort to maintain a large, stable flow



of funds into the housing market. But during periods of inflation, these efforts have been largely unsuccessful, because of another simple fact: housing is only one part of our economy -- certainly an important part -- but only a single sector, nonetheless. It must compete for funds in the money market with all other sectors of the economy. And if we want to ensure that funds are available for housing, we must take that competition into consideration.

The fact that housing is a part of our economy means that the housing industry is subject to all the stresses and strains that occur within a free market system. In fact, it is even more exposed and more vulnerable to changes in the economic health of our society than most other segments. Your industry's experience in 1966, 1969 and this past year documents that.

The question for us today is obvious: How can we help housing to compete more effectively for funds in the money market? How can we ensure that the housing industry will be provided with a relatively stable flow of funds, particularly during periods of inflation when high interest rates are generated?

These aren't easy questions to answer. The system of specialized thrift institutions, whose major purpose is to provide residential mortgage funds, has not worked -- even though they have been encouraged by successive grants of privileges or inducements. Additional inducements might help a little, but during periods of inflation, I don't think they would help enough.



The plain truth is that every time we go through a period of rapid inflation accompanied by tight money, we run into cyclical problems with the flow of funds to housing. It happened in 1966, when residential construction expenditures fell by about one-fifth. It happened in 1969. And it happened again in 1973.

Given these cyclical problems, it seems to me that those of us in this housing foxhole -- and I include myself in that category -- should give serious consideration to alternative solutions to these problems. Specifically, we should be asking ourselves: Are there other methods of financing housing that might better ensure a relatively stable flow of funds to your industry?

I believe the plan outlined in the Financial Institutions Act offers a better alternative because it looks at housing finance realistically as a part of the general money market. One of the basic purposes of the Act is to broaden the base for housing finance by making it attractive for all financial institutions to invest in it. As an incentive, the Act provides for a tax credit based on residential mortgage income to encourage all lenders to make housing loans.

Now, at the risk of appearing self-serving, let me point out that other lenders besides non-bank thrift institutions already are heavily involved in the housing market. For example, banks provide about half the housing construction loans in this country. And consider these figures in a report released by HUD this past December:



-- By September 1973, banks had increased their new commitments in long-term residential loans by 8 per cent over September 1972. This compared with a 46 per cent decrease over the same period for nine other groups of lenders.

-- Net acquisitions of long-term residential loans by banks for the first three quarters of 1973 were 5 per cent higher than the same period in 1972. That's \$14.3 billion compared to \$13.6 billion.

-- In the first nine months of 1973, acquisition of residential construction loans by banks rose 16 per cent over the comparable 1972 period.

-- Banks accounted for 25 per cent of the total net acquisitions of residential long-term and construction loans during the January-September 1973 period.

All of this involvement by banks in the housing market has occurred without one dime of incentive. Consider how much more extensively banks and other financial institutions might become involved in housing if they had the added incentive of a tax credit.

One may question whether the proposed 3.5 per cent tax credit would generate the desired amount of funds for the residential mortgage market. The size of the credit might have to be increased or decreased to adjust the flow of funds.

We do suggest, however, two modifications in the tax credit proposed in the Act to make it more equitable and more effective. First, we believe it should apply to loans for mobile homes and to all activities related to the provision



of housing. This would include land development loans, lines of credit to contractors, construction loans, warehousing of mortgages, and permanent residential mortgages. Second, if this incentive is to be effective, it must be applied uniformly to all lenders -- without a graduation in rates -- on the income flow from housing loans.

But despite these qualifications, I believe an incentive available to all lenders could increase the flow of funds to housing. Perhaps more important, it would free the housing industry from an unfortunate dependency on one type of financial institution for long-term mortgage funds.

Why do I say unfortunate? Because these institutions depend almost exclusively on consumer-type time and savings deposits as a source of funds for home financing. As a result, the aggregate supply of residential mortgage credit from private lenders declines when deposit inflows to these institutions shrink.

During the last few years the swings in these deposit flows have been massive. Look at the 1967-1969 period. When money market interest rates rose rapidly, the increase in total deposits at S&Ls and mutual savings banks was cut more than half. But in 1970, short-term market interest rates fell substantially. As a result, the net deposit inflow to non-bank thrift institutions doubled -- regaining its 1967 level. And it more than doubled again in 1971. We are caught in the same cycle today. In the words of the Federal Reserve Board, "Such



alternations of feast and famine are bound to create instability in mortgage credit supplies and in home building."

The Financial Institutions Act of 1973 recognizes the problems inherent in this situation and attempts to alleviate them by several actions. Among other things, it would broaden the powers of non-bank thrift institutions. Federal thrift institutions, savings and loan associations and mutual savings banks would be authorized to offer checking-type accounts, NOW accounts and credit cards to all customers. They would also be given the authority to make consumer loans -- a step that could increase their liquidity through a more rapid turnover of part of their loan portfolio. Hence they should be less vulnerable to the strains of tight money periods. But at the same time, they would relinquish the special privileges that originally were provided to help them weather such tight money periods -- privileges which have proven largely ineffectual.

Perhaps most important, the Financial Institutions Act recognizes the fundamental reality of housing finance: The primary competition for funds is not between banks and thrift institutions. The primary competition exists between regulated financial institutions and the unregulated portions of the money market.

Our experience last year is an excellent example of that competition. When short-term interest rates began to climb in the money market, savers began withdrawing money from both banks and non-bank thrift institutions to invest in general money market instruments. Thrift institutions -- banks and non-



banks alike -- could not compete successfully with the general money market because their interest rates were strictly regulated. Furthermore their ability to pay higher rates was limited by a portfolio of long-term loans with fixed, relatively low-rate loans. You know the results of that savings outflow. You're living with them today.

The Financial Institutions Act takes an initial step in correcting this basic imbalance in competition between the regulated and unregulated sectors of the market. It would eliminate interest rate ceilings on FHA and VA loans, thereby wiping out at least one impediment to flexible earnings and thus one restriction on the flow of funds to housing during periods of high interest rates.

For these various reasons, then, I believe this Act offers an improvement over our present system of housing finance -- a system where housing is overly dependent on one source of funds and excessively sensitive to cyclical fluctuations in interest rates.

There are, of course, other measures which would supplement this basic change.

One would be the removal of all usury ceilings imposed by state laws, an action similar to the removal of FHA and VA mortgage rate ceilings. During periods of tight money, these laws seldom protect the consumer. They do restrict, however, the amount of mortgage money available to him. During this past year all of us have seen or heard of instances where usury laws made it difficult for prospective home-buyers to find mortgage



financing because funds were placed in high-yielding obligations. ✓
In fact, in certain regions of the country, or for certain classes
of loans, mortgage funds almost vanished.

A second beneficial action would be the introduction of
variable rate mortgages -- that is, mortgages whose interest rates
varied with interest rates in the general money market. Such
instruments would enable financial institutions to compete more
successfully for residential mortgage funds. It would be
particularly helpful to those institutions that borrow short and
lend long. And it certainly would offer an inducement to those
lenders who are reluctant to tie up money for long periods of
time because of concern over inflation and increases in interest
rates.

Certainly the concept of variable rate mortgages raises
major economic and consumer questions. How would lenders make
sure borrowers fully understood exactly what was involved in such
a transaction? Could economists develop a satisfactory
statistical measure on which to base variations in interest rates?
How far would interest rates have to fluctuate before mortgage
rates would change? If interest rates rose, would the borrower
make a larger monthly payment -- or would he simply pay the same
✓ amount for a longer number of months to offset the higher rates?

Finally, I don't think we can ignore the need for a continued
and perhaps more active secondary market for mortgages. From a
practical standpoint, improvements and greater uniformity in
residential mortgage instruments and procedures almost certainly
would increase their negotiability.



All of these measures really are not much more than palliatives -- measures designed to divert more funds into housing and to maintain that flow of funds at a stable rate throughout cyclical fluctuations of interest rates. The ideal solution, of course, is to develop a stable, non-inflationary economy in which short-term fluctuations in interest rates are minimized. This depends upon sound governmental economic policies, better fiscal policies and improved monetary policies. But given the economic realities of 1974 -- continued inflation coupled with shortages of energy, of capital and of certain raw materials -- I doubt that we'll see the emergence of such an economy any time soon.

So, recognizing the fact that interest rates almost certainly will continue to fluctuate, I believe we must consider the alternatives to the present over-reliance on specialized thrift institutions. Of those alternatives, I believe the Administration's Financial Institutions Act supplemented by the other measures mentioned previously, makes the most sense.

It is based on the recognition that the residential mortgage market is an inseparable part of the broader money market and therefore subject to all the forces in that market. And it recognizes that housing, although certainly an important sector of our economy, must compete with other economic sectors for scarce funds in that market.

It recognizes that housing to date has been overly dependent on a single group of lenders -- lenders that specialize in mortgage lending and thus accumulate assets having fixed



interest rates and a long average life. Consequently, the average yield on their earning assets changes slowly when current market interest rates rise (or fall). Therefore, these non-bank thrift institutions are unable to compete for the consumer's savings -- and to maintain their mortgage lending -- when yields on market securities become considerably more attractive.

For these reasons, the Act acknowledges that housing is unusually vulnerable to fluctuations in interest rates and stresses created by tight money. And it recognizes that broadening the sources of housing funds under equal competitive conditions almost certainly would increase the stability of the flow of funds to housing.

Among other things, the Act attempts to meet two vital needs. First, it seeks to increase the flexibility and stability of non-bank thrift institutions by broadening their powers so they can continue to be a major source of housing funds.

Second, the Act broadens the source of funds for housing by offering an incentive to all financial institutions to expand their long-term mortgage portfolios. A larger, more diverse source of funds guarantees the housing industry a more stable flow of money in periods of tight money and rising interest rates.

Certainly the Act is not perfect. I've already pointed out that bankers have reservations on certain parts of this package. But given the current economic realities -- and the current state



of housing finance -- I believe it offers an attractive alternative to our present system. I believe if you'll "try it, you'll like it."

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SPEECH HIGHLIGHTS

Managing Change in Our Financial Structure

The Financial Institutions Act proposes to cope with numerous changes that have occurred in our economic and financial system since the 1930's. The outlines of that system were established by crisis legislation of that period. And the system itself has been modified since then through amendments designed to cope with succeeding crises -- all of which has resulted in an imbalance in our financial system. The FIA is designed to restore balance, flexibility and efficiency in that system and to encourage the creation of capital.

If the proposals outlined in the Financial Institutions Act of 1973 are to succeed, however, the ABA believes they must be based on three inter-related principles. First, they should provide adequate funding for housing over a long period of time. Second, they should give all financial institutions greater lending stability during periods of rapidly rising interest rates. Third, because the American public is best served by the free play of competitive forces, there should be ground rules which provide competitive equality for all institutions.

The only way to achieve these goals is through a comprehensive plan such as that outlined by the Administration. There are, however, several areas where the ABA believes the Administration plan is in need of modification.

The ABA continues to oppose compulsory Fed membership and the imposition of Federal Reserve Requirements on nonmember banks. In attempting to achieve a more equitable restructuring of reserve requirements, we must be careful not to do irreparable harm to the duality of our banking system.

The ABA sees no need to phase out Regulation Q, at least for the foreseeable future. The existing Interest Rate Control Act is flexible. It permits the regulatory agencies to vary the ceilings if conditions warrant. The ABA does believe that differentials in rates that the various kinds of financial institutions are permitted to pay on time deposits should be phased out.

The ABA opposes the continuation of NOW accounts for all financial institutions. In 1933 Congress wrote into law a specific prohibition against the payment of interest on checking accounts. This prohibition may need to be reviewed in light of current conditions. But until such a review takes place, we will oppose the backdoor skirting of the law that is represented by NOW accounts.

Because we recognize the need for stabilizing the flow of funds to housing, we favor in principle a tax credit on residential mortgage income to encourage all lenders to make housing loans. But we believe this incentive should be uniformly applied to all lenders -- especially in terms of its scope and the rate of the tax credit. This means that residential-type construction loans, mobile home loans and loans for new and existing housing should be covered by this incentive.



The ABA believes that the best way to increase the flow of funds into housing is to extend housing inducements to all segments of the financial system. Such a system relies on the money market as a whole to finance housing, rather than on a single specialized source of funds.

The ABA believes the FIA serves two important purposes: It provides a means for the system to adjust to changes that have already occurred -- and thus to restore balance to the economic system; and it provides a framework to maintain that balance by adjusting changes in the future.



MANAGING CHANGE IN OUR FINANCIAL STRUCTURE

Remarks by Rex J. Morthland
President, American Bankers Association

Before the Arizona Bankers Association
Phoenix, Arizona
November 1, 1973



In the midst of all the turmoil on the national scene, one major event seems to have escaped public notice. On October 12, 1973, the Nixon Administration submitted to Congress long-anticipated legislation proposing major changes in our financial structure. In any other year, the Financial Institutions Act of 1973 would have warranted front page headlines. But in the current climate of crisis and upheaval, it almost escaped notice.

I think this is unfortunate, because this legislation is indeed important -- not only for bankers but for the public it is designed to benefit. It proposes major changes in our financial system -- changes that, as the Administration says, are based on the belief that "the public interest is generally better served by the free play of competitive forces than by the imposition of rigid and unnecessary regulation." As we look at these proposals, I think it's important to keep this underlying principle in mind.

Even if the proposals have escaped the notice of the public, we as bankers cannot afford to let them escape ours. Indeed, we must take a very close look at this package. And that is precisely what I propose to do today -- to look long and hard at the Administration's proposed legislation, to examine what the ABA believes should be our position on these proposals, and finally to discuss where we go from here.

First of all, any discussion of the Administration plan is fruitless unless we understand exactly what that plan is. The legislation is highly complex and I know many of you have not yet had a chance to really read it through. So let me take a few minutes to outline the general scope of what the Administration is proposing.



The proposals fall into five main categories, the first category of which is certainly the most controversial. It deals with the payment of interest on deposits and new deposit powers.

The most controversial of these proposals would eliminate Regulation Q ceilings over a 5 1/2 year period after enactment of the legislation. Under the Administration's plan, the difference between rates paid by banks and those paid by specialized thrift institutions would be maintained for a year and a half. Then four annual increases in deposit interest rates paid by banks would phase out existing rate differentials. As you would expect the thrift institutions already have come out very strongly against both parts of this proposal. And while the ABA has endorsed phasing out interest rate differentials, we do not believe that the public interest would be best served by eliminating Regulation Q ceilings now or in the foreseeable future. I'll explain the rationale behind that position in a few minutes.

The Administration also is proposing that federal thrift institutions be permitted to offer demand deposits, NOW accounts and credit cards to all customers - both commercial customers and private individuals. These institutions would include federally chartered S&Ls and mutual savings banks. Let me add that the ABA believes such institutions should be given third party payment authority only for personal accounts. Extending this authority to corporate accounts would not be consistent with the role of specialized thrift institutions. By the same token, banks would be permitted to offer NOW accounts and savings accounts to all customers. A uniform interest rate ceiling -- no higher than that for bank passbook savings -- would be set for NOW accounts held at both banks and thrift institutions.

I believe we all agree that for all intents and purposes, NOW accounts are really nothing less than interest-bearing checking accounts. And for reasons that I'll make clear in a moment, the ABA is opposed to making them available to either banks or thrift institutions. It would seem, however, that the Administration shares some of our reservations, because the Financial Institutions Act states that the prohibition of interest payment on demand deposits will continue. Evidently the



accounts and checking accounts would give thrift institutions time to attract NOW-type accounts. In the words of the Administration, such a distinction would "introduce a degree of gradualism into the new world of paying interest on demand deposits."

Related legislative provisions call for the Federal Home Loan Bank Board and its regional banks to serve as check clearing agencies with authority similar to that of the Fed. In addition, thrift institutions would have direct access to Fed clearing facilities. These proposals were only hinted at in the Administration's August narrative plan and therefore deserve careful study before we can arrive at a well-reasoned position. But even at this early stage, it's obvious that they would have important implications for effective implementation of monetary policy, and for correspondent banking.

A real surprise in the Administration bill is the inclusion of so-called "truth-in-savings" provisions. These would require full disclosure to customers of rates, terms, charges and restrictions of interest payments on deposits. Much of the language is identical to Senator Vance Hartke's proposed "Consumer Savings Disclosure Act," on which Senate hearings were held last June. And I think it's apparent that these provisions were included to attract the support of consumer groups.

Our position on this is clear. We agree that every depositor should be given the terms and conditions of his deposit in clear, understandable language. And we hope that complicating regulations will not be necessary to guarantee this obvious right.

The second major category of proposals deals with treatment of reserves on deposits held by various financial institutions. Under the Administration legislation, the Fed would be given authority to set reserve requirements on checking and NOW accounts for both member banks and thrift institutions that are members of the Federal Home Loan Bank System. Reserves for non-member banks and non-member thrift institutions would not be subject to Fed reserve requirements. And state-chartered S&Ls would not have to be members of the Home Loan Bank system to be insured by the Federal Savings and Loan Insurance Corporation.



These provisions are an improvement over the original Hunt Commission recommendation of compulsory Federal Reserve membership and suggested uniform reserve requirements for all financial institutions. But the debate on this issue continues.

And the Administration has stated that the question of uniform reserve requirements is beyond the scope of its recommendations -- and indeed, that such requirements would "not necessarily" be harmful to the dual banking system.

I want to make it clear right now that the ABA does not agree. At our recent annual convention in Chicago, the chairman of our Government Relations Council stated the ABA's position quite clearly: "We will continue to oppose compulsory Fed membership and the imposition of Federal Reserve requirements on nonmember banks. Our job is to be sure that the Administration plan to achieve a more equitable restructuring of reserve requirements does not do irreparable harm to the duality of our banking system."

The third category of proposals deals with the complex area of taxation. The objective is a uniform tax system for all financial institutions. Without going into too much detail, let me just say that the Administration is proposing that the special bad debt reserve provisions for thrift institutions be eliminated. Thrifts would then compute reserves for loan losses in a manner similar to banks. At the same time, however, the Administration is proposing a tax credit to offset the potentially higher income taxes on thrift institutions and serve as an incentive for additional mortgage lending. The credit would be equal to a percentage of gross income received from residential mortgages. It would be available to all types of financial institutions and would be calculated on a sliding scale keyed to the per cent of assets invested in residential mortgages.

In the interest of competitive equality, the ABA believes all competing financial institutions should be covered by the same bad debt reserve treatment. We therefore applaud the Administration's proposals to put that principle into practice. Furthermore, the proposed special tax credit for residential mortgages would afford compensation for adjusting a financial institution's bad



debt reserve treatment. The amount of tax credit would depend on how strongly a financial institution is oriented toward housing. The decision would be made by each individual financial institution under rules applying uniformly to all. I want to talk a little more about this proposal a little later.

The fourth category of proposals provides increased lending and investment powers for both specialized thrift institutions and banks.

Under the legislation, thrifts would be permitted:

- to make consumer loans up to 10 per cent of total assets;
- to make real estate loans in the same manner as national banks;
- to offer unsecured lines of credit to builders for construction financing;
- to make community welfare and development "leeway" investments up to 3 per cent of total assets; and
- to hold high grade commercial paper and corporate debt security investments up to 10 per cent of total assets, phased in over five years.

Thrifts could use "leeway" authority and investment authority so that under some conditions they could make consumer loans up to 23 per cent of assets.

By the same token, national banks also would receive expanded lending powers. They would be allowed to make real estate loans on the same basis as other loans and to invest up to 3 per cent of their assets in community welfare and development projects. In addition, the Fed and the Federal Home Loan Bank Board would have more authority to define financial institution assets eligible for discount and advances.

Of course, we all realize that these proposals constitute very broad additions to the powers of thrift institutions. And some of them could well contribute to the cyclical stability of these institutions as a class. The authority to make consumer loans, for example, would increase their gross income and provide some liquidity through a more rapid turnover of part of their portfolios. This would be particularly helpful to them in periods of tight money.



But if thrift institutions obtain increased powers to enhance their cyclical stability, they should not retain the special privileges they now have. In the public interest and in the interest of more equitable competition among financial institutions, the ABA will insist that thrifts be subject to the same limits on deposit interest rates, uniform taxes and the same reserves -- before or when they are given additional lending and investment powers.

My fifth and final category for summarizing these proposals is something of a catch-all. The Administration proposes to eliminate interest rate ceilings on FHA and VA loans. The ABA certainly supports such a proposal, because we as bankers recognize the undesirable effects of usury laws in constricting the flow of funds to housing and to other areas in our economy.

The Federal Home Loan Bank Board would be given additional authority to charter federal stock thrift institutions having the same powers as federal mutual S&Ls. And conversions of mutual thrift institutions to stock form would be made easy. We can certainly understand the desire for such changes since they would bring about a complete "dual system" for both banks and thrift institutions. In effect, the Administration proposals would give stock thrifts the power to choose whether they preferred to be chartered by their home states or by the federal government.

And finally, the legislation would give credit unions modestly liberalized powers over rates and terms of loans. It would authorize the establishment of a National Credit Union Administration Discount Fund to meet temporary liquidity problems of insured credit unions. Incidentally, I think I should note that credit unions are not included in the Administration's definition of thrift institutions.

These, then, are the main points of the Financial Institutions Act of 1973. I've briefly outlined the ABA's position on some of those points, but I would like to take a few minutes more to elaborate on the rationale behind those positions.



I believe we all recognize that there are some very basic problems in our nation's financial structure. And I believe that's true despite the tremendous job that banks have been doing in trying to meet the nation's financial needs. The problem is not so much in our own efforts as in the structure within which we operate. And this problem shows up repeatedly in various sectors of the economy. Housing is a good example.

Every time we go through a period of tight money, we run into cyclical problems with the flow of funds to several areas, including housing. And this, in turn, generates concern with the liquidity of thrift institutions -- and equal concern for the stability of the housing industry made up of thousands of firms that are important bank customers. In one respect, at least, the problems of housing finance in 1966, 1969 and 1973 were useful -- they revealed some of the inadequacies of our present financial set-up.

The Administration proposals are intended to minimize these inadequacies. But if they are to succeed, the ABA believes they must be based on three inter-related principles. First, they should provide adequate funding for housing over a long period of time. Second, there should be prudent and responsible changes in the powers of financial institutions to give them greater lending stability during periods of rapidly rising interest rates. And third, as the Administration says, because the American public is best served by the free play of competitive forces, there should be ground rules which provide competitive equality for all institutions.

Our position on the Administration's legislation is based on all three of these principles or goals. And I think it's fairly obvious that the only way we're ever going to come close to achieving these goals is through a comprehensive coordinated plan for managing change in our financial system. Only through such a plan would we be able to make major adjustments to meet the needs of all financial institutions -- something we must do if we hope



to bring about any sort of equitable balanced change. As the Hunt Commission said of its own proposals, "We believe that piecemeal adoption of the recommendations raises the danger of creating new and greater imbalances."

If we accept the need for a comprehensive approach to bringing about changes, then I think we must recognize that among all the proposals we've seen -- including Patman's package and the National Association of Home Builders' plan -- the Administration's legislation presents the most acceptable approach to managing these changes.

This is not to say, however, that we must endorse the Administration's proposals without any modifications. Indeed, there are several areas where the ABA -- and I think most bankers -- would disagree with the Administration plan.

The most obvious disagreement concerns the proposal to phase out Regulation Q ceilings. We do agree it is essential to eliminate differentials in interest rate ceilings for different competing financial institutions. Such differentials have not achieved the purpose of protecting the flow of funds to housing, nor have they provided stability in the financial system. Yet millions of our savings depositors have continued to earn less on their savings than customers of thrift institutions. This is economically unfair to our customers and competitively unfair to banks.

It may be that in the long run, the public interest could be served by phasing out of all deposit interest rate ceilings. But the experience of recent weeks raises real questions as to whether such action now is in the best interest of both the borrowing and the saving public. Because of that experience, Congress has approved a joint resolution requiring federal regulators to establish ceilings on time deposits under \$100,000. Clearly Congress is concerned about the potentially detrimental effects of eliminating deposit rate ceilings. The existing Interest Rate Control Act is flexible. It can accommodate change. It permits the regulatory agencies to vary the ceilings --



or suspend them altogether for deposits of over \$100,000 -- if conditions warrant. And in the interest of the saver-consumer, we would hope that the regulatory agencies would recognize free market forces in establishing the maximum limits on deposit interest rates. But we do not support total elimination of those ceilings now or in the foreseeable future.

The second major area where we differ with the Administration is on the issue of NOW accounts. A few minutes ago I said that we opposed them. Let me explain why. In 1933 Congress wrote into law a specific prohibition against the payment of interest on checking accounts. We believe this prohibition should be reviewed in light of current conditions. But until such a review takes place -- and unless Congress decides to remove that prohibition -- we will oppose the backdoor skirting of the law that is represented by NOW accounts. To my mind, at least, it makes no sense to continue this prohibition against payment of interest on demand deposits while advocating NOW accounts for all financial institutions, as the Administration legislation proposes.

The third area of difference with the Administration plan concerns incentives for housing. As I said earlier, the Administration is recommending a tax credit on residential mortgage income to encourage all lenders to make housing loans. And because we recognize the need for stabilizing the flow of funds to housing, we would favor this proposal in principle. But we believe this incentive should be uniformly applied to all lenders -- especially in terms of its scope and the rate of the tax credit. This means that residential-type construction loans, mobile homes, and loans for new and existing housing should be covered by this incentive.

Furthermore, we believe this incentive should be large enough to do what it is designed to do -- channel an adequate flow of funds into housing. The administration is proposing a tax credit of 3.5 per cent of earned interest for financial institutions with at least 70 per cent of their portfolios invested in housing



loans. The credit would be graduated downward for lenders with less than 70 per cent in housing loans. But the ABA believes that 3.5 per cent is not enough to "have a substantive impact in encouraging all lenders to increase the funds available for housing." We believe the credit should be increased and further, that it should be applied uniformly -- without a graduation in rates -- on the income flow from housing loans.

That brings us down to the present and that inevitable question: Where do we go from here? Let me suggest one possible course of action. Once we accept the need for a comprehensive, coordinated approach to managing changes in our financial structure, I believe we will find the Administration plan is our best chance to make those changes work. And that implies a unified industry-wide strategy to work for the modification of the Administration's legislative proposals -- to make those proposals an acceptable means of remedying the inadequacies in our present financial structure

I think we are in a good position to do precisely that. For one thing, the proposals were submitted to Congress only last month. And while the Senate plans to hold preliminary hearings with regulatory agency witnesses this month, the major part of the hearings in both the Senate and the House won't get underway until next year. It took 18 months for the Hunt Commission to come up with its recommendations -- and 21 months for the Administration to submit legislation to Congress. It's unrealistic to expect Congress to act with any great speed on such important issues.

All of which means we have time -- time to make our position known, time to explain the rationale behind our specific objections, time to offer alternatives to specific proposals, time to persuade Congress of the need to make modifications in the Administration plan. The ABA already has begun to assemble facts and information that will be needed to back up our position. We have begun studies of the efficacy of mortgage lending incentives outlined in the Administration legislation. And we're working to assess the impact of



NOW accounts on interest rates charged to borrowers.

Beyond that, I believe we bankers must continue our very active dialogue with key Administration officials, legislators and regulators on the broad issue of comprehensive change in the nation's financial structure. I think we must reserve the right to respond to any initiatives taken separately from the Administration' proposals. And we should oppose vigorously any further attempts to make piecemeal changes in the competitive structure of the nation's financial institutions while the Administration proposals are under consideration in Congress.

That is where we are now and where I think we should be going -- because to my mind, we have little choice. In a world where change is occurring at an ever increasing pace, we must work with the tools available to us. And right now, the best tool available for managing those changes is the Administration plan for financial reform. If we are willing to work with this plan, if we can refine it to meet the financial needs of the American public more effectively, then both the public and financial institutions cannot help but benefit. And isn't that what banking is all about?

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SPEECH HIGHLIGHTS

The Consequences of Our Choices

We live in an economic democracy under which we have freedom of choice, both as producers and as consumers. We have freedom of choice -- but not freedom from the consequences of our choices.

Our economic system is highly complex -- every part is related to every other part, and what affects one segment of the economy eventually will be felt across the entire economic spectrum. There are at least five basic principles that shape our economic system.

(1) Ours is an economy of scarcity -- witness the shortage of loanable funds at interest rates considered acceptable by our society. In such a situation we must take care to consider the interests of savers as well as borrowers . . . individuals as a group are the net savers in our society . . . we owe it to them to make sure they get the highest possible return for their funds.

(2) As a society, we cannot consume more than we produce currently or have accumulated out of past production. (3) Under our economic and democratic system, we have relative freedom of choice -- we can decide how we want to allocate our scarce resources. (4) Our economy allocates scarce resources largely through a price mechanism in which all participants seek to maximize returns. (5) In a capitalist economy, government can influence the direction of economic forces or changes, but it cannot control all of them. In general, government's function is to set and enforce the rules under which our economy operates.

These observations may seem overly simplistic, but a brief summary of our attempts to control inflation during the 1960's and early 1970's will illustrate their importance. Such a history highlights six points:

(1) People will observe controls voluntarily for only a limited period of time--and then only when they believe others are equally affected by the controls. (2) Effective controls of prices in one segment of the economy lead successively to controls in other portions of the economy. (3) It would take a massive bureaucracy to formulate and enforce such controls. (4) The forces of supply and demand cannot be repealed by government edict. (5) We cannot control prices on commodities produced mainly by other nations. (6) Other nations cannot be isolated from the effects of our own inflation, nor are we isolated from their economic problems.



THE CONSEQUENCES OF OUR CHOICES

Remarks by Rex J. Morthland

President, The American Bankers Association

Montgomery Chapter

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Montgomery, Alabama

November 6, 1973



THE CONSEQUENCES OF OUR CHOICES

WE LIVE IN AN ECONOMIC DEMOCRACY UNDER WHICH WE HAVE FREEDOM OF CHOICE BOTH AS PRODUCERS AND AS CONSUMERS. IN THE WORDS OF RECENTLY-DECEASED ECONOMIST LUDWIG VON MISES, IT IS A SYSTEM WHERE WE "LET INDIVIDUALS CHOOSE HOW THEY WANT TO COOPERATE IN THE SOCIAL DIVISION OF LABOR, AND LET THEM DETERMINE WHAT THE ENTREPRENEURS PRODUCE." WE ALSO LIVE IN A POLITICAL DEMOCRACY WITH FREEDOM OF CHOICE OF GOVERNMENTAL ACTION. IT WOULD BE DIFFICULT FOR ONE TO EXIST WITHOUT THE OTHER. A MAJOR ADVANTAGE OF THIS SYSTEM OF THE TWO DEMOCRACIES IS THAT EXCESSIVE USE OF ONE KIND OF POWER--EITHER ECONOMIC OR POLITICAL--IS COUNTER-balanced by the other. NO SUCH COUNTER-BALANCES EXIST IN ANY OTHER FORM OF ECONOMIC OR POLITICAL ORGANIZATION. NOTE WELL, HOWEVER, THIS SYSTEM DOES NOT PROVIDE A SAFEGUARD TO ASSURE OUR MAKING THE CORRECT CHOICES IN EITHER FIELD. MY THESIS, THEN, IS THAT WE HAVE FREEDOM OF CHOICE BUT NOT FREEDOM FROM THE CONSEQUENCES OF OUR CHOICES. WE MUST CONSIDER, AND BE WILLING TO ACCEPT, THE CONSEQUENCES BEFORE WE MAKE OUR CHOICE.

OUR ECONOMIC SYSTEM ALSO IS A CAPITALISTIC, HIGHLY COMPLEX ONE WITH ALL THE COMPLICATIONS AND PROBLEMS INHERENT IN DECISIONS BEING MADE BY A NUMBER OF INDEPENDENT UNITS. IT IS BASED ON A FIRM BELIEF THAT THE PRICING MECHANISM, ALWAYS PULLING SUPPLY AND DEMAND TOWARD EQUILIBRIUM--BUT NEVER QUITE REACHING IT--IS THE KEY TO THE BEST USES OF RESOURCES--AND INDIRECTLY, TO A FREE AND CREATIVE SOCIETY. EVERY PART IS RELATED TO EVERY OTHER PART, AND WHAT AFFECTS ONE SEGMENT OF THE ECONOMY, EVENTUALLY WILL BE FELT ACROSS THE ENTIRE ECONOMIC SPECTRUM.



THE INTERRELATIONSHIP OF ALL SEGMENTS OF OUR ECONOMY IS A POINT WE SOMETIMES FORGET PARTICULARLY TODAY WHEN CHANGE SEEMS TO BE OCCURRING AT A MORE RAPID PACE. WE MUST MAKE DECISIONS ABOUT PROPOSALS FOR CHANGE IN OUR FINANCIAL SYSTEM. WE FACE RECORD HIGH LEVELS OF INFLATION. WE MUST DEVELOP NEW METHODS OF SPURRING ECONOMIC GROWTH IN THE FACE OF SHORTAGES. AND AS WE DEAL WITH THESE PROBLEMS, I'M CONCERNED THAT WE MAY ATTACK THEM IN A PIECEMEAL MANNER--ONE AT A TIME--WITHOUT CONSIDERING HOW THEY RELATE TO EACH OTHER AND HOW THE SOLUTIONS WILL AFFECT THE ENTIRE ECONOMY.

FOR THIS REASON, IT SHOULD BE WORTHWHILE FOR US TO DISCUSS THE PRINCIPLES THAT FORM THE BASIS OF OUR ECONOMIC SYSTEM. BEYOND THAT WE NEED TO TAKE A LOOK AT SOME OF THE FUNDAMENTAL RELATIONSHIPS BETWEEN PARTS OF OUR ECONOMY. INDEED, I BELIEVE WE MUST DO THIS IF WE ARE TO MEET THE CHALLENGE AND CHANGE OF THE SEVENTIES SUCCESSFULLY.

TO MY MIND, THERE ARE AT LEAST FIVE BASIC PRINCIPLES THAT SHAPE OUR ECONOMIC SYSTEM. FIRST OF ALL, WE MUST RECOGNIZE THAT WE LIVE IN AN ECONOMY OF SCARCITY. IT SIMPLY IS NOT POSSIBLE TO SATISFY ALL NEEDS FOR GOODS AND SERVICES WITH OUR SCARCE RESOURCES. THE REASON IS SIMPLE. OUR DESIRES INCREASE MORE RAPIDLY THAN OUR PRODUCTIVE CAPACITY.

FURTHERMORE, THERE ARE SIGNS THAT WE MAY BE RUNNING OUT OF CERTAIN VERY BASIC RESOURCES ALTOGETHER. FAR FROM BEING THE AFFLUENT SOCIETY WE ONCE CONSIDERED OURSELVES, MORE AND MORE



ECONOMISTS ARE BEGINNING TO DUB OUR ECONOMY THE SHORTAGE ECONOMY. OF COURSE, THE PRIMARY SHORTAGE ON ALL OUR MINDS RIGHT NOW IS THE ENERGY SHORTAGE. AND I CERTAINLY DON'T HAVE TO TELL IOWA BANKERS HOW SHORTAGES OF FUEL ARE GOING TO AFFECT THE SUPPLY OF FOOD IN THIS COUNTRY NEXT YEAR.

BUT THERE'S ANOTHER SHORTAGE I THINK WE SHOULD BE AWARE OF--THE SHORTAGE OF LOANABLE FUNDS AT INTEREST RATES CONSIDERED ACCEPTABLE BY OUR SOCIETY. WE'VE ALREADY EXPERIENCED A CERTAIN AMOUNT OF CAPITAL SHORTAGE THIS YEAR. AND I'M AFRAID IT'S GOING TO GET WORSE. INDUSTRY, CONSUMERS AND GOVERNMENT ARE ALL PUTTING UNPRECEDENTED DEMANDS ON OUR LIMITED POOL OF CAPITAL. AND JUDGING FROM THE WAY OUR POLITICAL-ECONOMIC SYSTEM HAS OPERATED IN THE PAST. I THINK WE CAN BE PRETTY CERTAIN WE'RE GOING TO CONTINUE FACING RECURRING INFLATIONARY PRESSURES AND PERIODS OF RAPIDLY RISING INTEREST RATES.

UNDER SUCH CIRCUMSTANCES WE MUST TAKE CARE TO CONSIDER THE INTEREST OF SAVERS AS WELL AS BORROWERS. THIS IS ESPECIALLY IMPORTANT IF THE PUBLIC INTEREST WE'RE ALWAYS TALKING ABOUT IS INTERPRETED IN TERMS OF INDIVIDUALS. INDIVIDUALS AS A GROUP ARE THE NET SAVERS IN OUR SOCIETY. IN PERIODS WHEN CAPITAL IS SHORT, WE OWE IT TO THEM TO MAKE SURE THEY GET THE HIGHEST POSSIBLE RATE FOR THEIR FUNDS. THIS IS BOTH A MATTER OF EQUITY AND AN INDUCEMENT TO SAVE MORE AND THUS REDUCE THE SHORTAGE.

TALK OF SHORTAGES LEADS ME TO A SECOND BASIC ECONOMIC PRINCIPLE. IT IS SIMPLY THIS: AS A SOCIETY WE CANNOT CONSUME MORE THAN



WE PRODUCE CURRENTLY OR HAVE ACCUMULATED OUT OF PAST PRODUCTION. IF WE WANT TO CONSUME MORE THAN WE HAVE, NOW WE MUST PRODUCE MORE.

THAT MEANS WE HAVE TO MAKE SOME CHOICES--AND THAT LEADS US TO THE THIRD PRINCIPLE. UNDER OUR ECONOMIC AND DEMOCRATIC SYSTEM, WE HAVE RELATIVE FREEDOM OF CHOICE. WE CAN DECIDE WHETHER WE WANT TO CONSUME EVERYTHING NOW, OR SAVE SOME AND INVEST OUR SAVINGS TO INCREASE FUTURE PRODUCTION. WE CAN DECIDE HOW WE WANT TO ALLOCATE OUR SCARCE RESOURCES. BUT, WE DO NOT HAVE FREEDOM FROM THE CONSEQUENCES OF OUR CHOICES. WE CANNOT ESCAPE THE RESULTS OF OUR DECISIONS. AS I SAID IN MY INTRODUCTION, THIS PRINCIPLE IS THE THESIS FOR THIS CHAT WITH YOU.

THIS MEANS THAT WE MUST HAVE AS MUCH ACCURATE INFORMATION AS POSSIBLE BEFORE WE MAKE DECISIONS. I DON'T HAVE TO TELL YOU THAT WE BANKERS MUST BE FULLY INFORMED. BUT THAT IS NOT ENOUGH. WE MUST MAKE SURE THAT CONGRESS AND THE REGULATORY AGENCIES ARE EQUALLY WELL-INFORMED ABOUT THE COMPLEX INTERRELATIONSHIPS IN OUR ECONOMIC SYSTEM. EVEN MORE IMPORTANT, THE PEOPLE REPRESENTED BY CONGRESS MUST COME TO UNDERSTAND HOW OUR SYSTEM WORKS AND THE THE EFFECTS OF THEIR DECISIONS ON THE EFFICIENT FUNCTIONING OF OUR SYSTEM.

ANOTHER POINT THAT MUST BE UNDERSTOOD CLEARLY BY ALL OF US IS OUR FOURTH BASIC PRINCIPLE: OUR ECONOMIC SYSTEM ALLOCATES SCARCE RESOURCES LARGELY THROUGH A PRICE MECHANISM THROUGH WHICH ALL PARTICIPANTS SEEK TO MAXIMIZE RETURNS. AS SELLERS OF RESOURCES



REGARDLESS OF WHETHER THEY ARE LAND, LABOR, ENTREPRENURIAL SKILLS OR CAPITAL -- WE ALL TRY TO OBTAIN THE (HIGHEST) PRICE THAT WILL MAXIMIZE PROFITS. AND AS BUYERS, WE TRY TO OBTAIN THESE RESOURCES FOR THE LOWEST POSSIBLE PRICE. THE SUM OF ALL OUR INDIVIDUAL DECISIONS TO BUY OR SELL DETERMINES HOW OUR RESOURCES ARE ALLOCATED.

OF COURSE, THE ACTIONS OF GOVERNMENT HAVE A MAJOR IMPACT ON THE DIRECTION OF OUR ECONOMY. AND THAT LEADS ME TO THE LAST PRINCIPLE. IN A CAPITALIST ECONOMY, GOVERNMENT CAN INFLUENCE THE DIRECTION OF ECONOMIC FORCES OR CHANGES, BUT IT CANNOT CONTROL ALL OF THEM. GOVERNMENT CAN LIMIT EITHER THE PRICE OF A PRODUCT OR ITS QUANTITY; IT CANNOT CONTROL BOTH. FURTHERMORE, OUR ECONOMY IS NOT INSULATED FROM THE ECONOMIC PRESSURES OF OTHER COUNTRIES. CERTAIN SEGMENTS OF OUR ECONOMIC SYSTEM ARE AFFECTED MORE BY THE ACTIONS OF FOREIGN GOVERNMENTS THAN BY OUR OWN.

THIS IS NOT TO SAY THERE IS NO NEED FOR GOVERNMENT ACTION IN OUR ECONOMIC DEMOCRACY. GOVERNMENT DISSEMINATES DETAILED, ACCURATE INFORMATION ON THE WAY OUR ECONOMY IS PERFORMING -- INFORMATION VITAL FOR EFFECTIVE PLANNING. IT PROMOTES COMPETITION AND GUARDS AGAINST THE ABUSES OF MONOPOLISTIC POWERS. AND IT CONCERNS ITSELF WITH SOCIAL PROBLEMS -- NEEDS NOT ALWAYS MET BY THE WORKINGS OF ADAM SMITH'S INVISIBLE HAND.

IN GENERAL, GOVERNMENT'S LEGITIMATE FUNCTION IS TO SET AND ENFORCE THE RULES UNDER WHICH OUR ECONOMY OPERATES. AND IN SO DOING, IT ACTS TO PREVENT THE EXPLOITATION OF THE ECONOMICALLY WEAK BY THE ECONOMICALLY STRONG.



THE FACT REMAINS, HOWEVER, THAT THERE ARE LIMITS TO HOW MUCH GOVERNMENTS CAN ACTUALLY DO TO AFFECT THE WORKINGS OF THE ECONOMY. AS WE HAVE ALL LEARNED RATHER PAINFULLY DURING THE PAST FEW YEARS, IF WE HAD NOT KNOWN IT BEFORE, FEDERAL REGULATORS CANNOT CONTROL ONE OR TWO ASPECTS OF THE ECONOMY WITHOUT AFFECTING OTHER EQUALLY IMPORTANT SECTORS. AND UNDER A FREE MARKET ECONOMY, GOVERNMENT CANNOT CONTROL ALL ECONOMIC SECTORS AT THE SAME TIME.

THIS BRIEF SUMMARY OF FUNDAMENTAL ECONOMIC PRINCIPLES MAY SEEM OVERLY SIMPLISTIC. BUT IT'S IMPORTANT TO KEEP THESE RULES IN MIND BECAUSE THEY ARE THE VERY BASIS OF OUR ECONOMIC SYSTEM. THE CURRENT PROBLEMS AND IMBALANCES IN OUR ECONOMY ARE AT LEAST PARTLY THE RESULT OF FAILING TO OBSERVE THESE FORCES -- OF OUR FAILURE TO MAKE THEM WORK FOR OUR BENEFIT.

BUT IF THESE RULES ARE SO OBVIOUS, HOW CAN WE FAIL TO OBSERVE THEM? I THINK THE REASON LIES IN THE FACTS THAT THEY ARE OBVIOUS, THAT PROSPERITY HAS MADE US INTELLECTUALLY LAZY AT TIMES, THAT WE ARE IMPATIENT AND SEEK QUICK, EASY ANSWERS, AND THAT WE SOMETIMES LACK SELF-DISCIPLINE. AND, WE MAKE MISTAKES BECAUSE OUR KNOWLEDGE IS NOT COMPLETE.

SOME OF OUR DECISIONS ARE BASED ON ONLY A LIMITED UNDERSTANDING OF HOW THE ECONOMIC SYSTEM ACTUALLY WORKS. AND BECAUSE WE DON'T UNDERSTAND THE SYSTEM FULLY, WE SEEK EASY, SHORT-RUN, FAST-ACTING SOLUTIONS TO OUR ECONOMIC PROBLEMS. WE MAY FORGET THAT EVERY PART OF THE ECONOMY IS INTERRELATED WITH EVERY OTHER PART -- SO THAT



SOMETIMES WE'RE SURPRISED WHEN THE SOLUTION TO ONE ECONOMIC PROBLEM GENERATES A WHOLE NEW SET OF DIFFICULTIES. SOMETIMES WE UNDERESTIMATE THE RESOURCES REQUIRED TO SOLVE A GIVEN PROBLEM -- AND SOMETIMES WE OVERESTIMATE THE RESOURCES AVAILABLE TO SOLVE ALL PROBLEMS. WE

FORGET THAT THERE IS A LAG BETWEEN THE TIME AN ECONOMIC ACTION IS TAKEN AND THE TIME ITS EFFECT IS FELT -- AND WE BECOME IMPATIENT. WISHFULLY WE PERSUADE OURSELVES THAT ECONOMIC EVENTS CAN BE CONTROLLED - NOT JUST INFLUENCED -- BY STATUTES AND REGULATIONS. AND FINALLY, WHEN THE SCALES DROP FROM OUR EYES AND WE RECOGNIZE WHAT MUST BE DONE TO SOLVE A PARTICULAR PROBLEM, WE SOMETIMES LACK THE DISCIPLINE TO ACTUALLY TAKE THE NEEDED ACTION.

PERHAPS THIS SEEMS AN OVERLY PESSIMISTIC VIEW OF HOW THE PUBLIC, LEGISLATORS, AND EVEN BANKERS MAKE ECONOMIC ERRORS. BUT I THINK A BRIEF SUMMARY OF OUR ATTEMPTS TO CONTROL INFLATION WILL ILLUSTRATE THESE OBSERVATIONS.

LET'S GO BACK TO THE EARLY 1960's, WHEN THE UNITED STATES WAS JUST BEGINNING TO COMMIT MAJOR AMOUNTS OF RESOURCES TO THE VIET NAM WAR. SOMEPLACE ALONG THE LINE, THE DECISION WAS MADE TO FINANCE THE WAR WITHOUT INCREASING TAXES. THE RATIONALE BEHIND THIS DECISION IS UNDERSTANDABLE. TAX INCREASES WOULD HAVE CUT INTO A RISING STANDARD OF LIVING. IT MIGHT HAVE REDUCED SAVINGS. AND IN THE EARLY STAGES OF FIGHTING, THE AVAILABILITY OF UNUSED RESOURCES MADE IT POSSIBLE TO EXPAND PRODUCTION THROUGH FEDERAL DEFICIT SPENDING -- WITHOUT GENERATING LARGE PRICE INCREASES.



BUT THE ULTIMATE RESULT OF THE DECISION NOT TO RAISE TAXES INEVITABLY WAS INFLATION. BOTTLENECKS IN PRODUCTION BEGAN TO APPEAR AS INCREASED PRODUCTION BEGAN USING ALL AVAILABLE SUPPLIES OF CERTAIN RESOURCES. SUPPLIES OF THESE RESOURCES OR PRODUCTS COULD NOT BE EXPANDED FOR A NUMBER OF REASONS. IN SOME CASES, SUCH AS AGRICULTURE, THE GOVERNMENT ACTUALLY LIMITED PRODUCTION THROUGH PRICE SUPPORT PROGRAMS THAT HAD BEEN INITIATED DURING THE 1930's. GOVERNMENT RESTRICTIONS ON IMPORTS ALSO ACTED TO LIMIT THE SUPPLY OF CERTAIN PRODUCTS. UNION RULES AND LOCAL CUSTOMS SOMETIMES ACTED TO LIMIT OUTPUT PER WORKER PER DAY. AND IN CERTAIN AREAS OF PRODUCTION, IT WAS DIFFICULT TO INCREASE THE NUMBER OF SKILLED WORKERS BECAUSE OF THE LENGTH OF TIME NECESSARY TO ACQUIRE TECHNICAL SKILLS, OR BECAUSE OF UNION RESTRICTIONS.

FURTHERMORE, CERTAIN VALUABLE RESOURCES WERE STILL NOT BEING FULLY USED. THE PRIME EXAMPLE WAS LABOR. IN THE FACE OF RISING PRICES, UNEMPLOYMENT STILL CONTINUED AT UNACCEPTABLY HIGH LEVELS FOR A NUMBER OF REASONS, GENERALLY RELATED TO THE INFLEXIBILITY OF WAGES ON THE DOWN SIDE. A NUMBER OF FACTORS HAVE PREVENTED WAGES FROM DROPPING TO LEVELS WHERE ALL AVAILABLE LABOR MAY BE EMPLOYED ECONOMICALLY. OTHER UNEMPLOYED WORKERS LACKED MARKETABLE SKILLS -- THE WORK OF AN INCREASING AMOUNT OF UNSKILLED LABOR WAS BEING TAKEN OVER BY MACHINES BECAUSE OF INCREASING WAGE LEVELS OR IMPROVED TECHNOLOGY. EMPLOYERS WERE RELUCTANT TO TRAIN UNSKILLED WORKERS FOR SEVERAL REASONS. IN SOME CASES, MINIMUM WAGE LIMITS MADE IT ECONOMICALLY IMPRACTICAL TO HIRE TRAINEES. IN OTHER CASES, UNION WAGE SCALES WERE SOMETIMES TOO HIGH



TO PERMIT ECONOMICAL TRAINING PROGRAMS. AND, ON CONTRACTS WITH THE FEDERAL GOVERNMENT, WAGE SCALES WERE SET BY THE GOVERNMENT AT A LEVEL THAT SOMETIMES PROHIBITED ON-THE-JOB TRAINING. THEN, CERTAIN SEGMENTS OF THE NATION'S MANPOWER POOL WERE SIMPLY NOT MOBILE -- THEY COULDN'T GO WHERE THE JOBS WERE.

THE NET RESULT OF ALL THIS WAS PERSISTENT INFLATION, WHICH IN TURN BRED A FIRM EXPECTATION OF CONTINUED INFLATION. INDIVIDUALS AND BUSINESSES JUST ASSUMED THAT PRICES WOULD CONTINUE TO CLIMB AND THEY ACTED ACCORDINGLY. THEIR ACTIONS IN TURN FUELED FURTHER PRICE INCREASES.

THIS WAS THE SITUATION WHEN THE NIXON ADMINISTRATION TOOK OFFICE IN JANUARY 1969. AND THROUGHOUT THE FIRST TWO YEARS, THE ADMINISTRATION SOUGHT TO CONTROL THIS PERSISTENT INFLATION BY ESTABLISHING A BALANCED FEDERAL BUDGET. THEY WORKED TO AVOID RAPID INCREASES IN THE MONEY SUPPLY THROUGH MONETIZATION OF ADDITIONAL GOVERNMENT DEBT. THEIR EFFORTS WERE PARTIALLY SUCCESSFUL.

BUT THE WAR IN VIETNAM CONTINUED CONSEQUENTLY GOVERNMENT NEEDS FOR SUPPLIES AND MATERIAL ALSO CONTINUED. FURTHERMORE, MANY SOCIAL ACTION PROGRAMS BEGUN PREVIOUSLY EXPANDED UNDER PREVIOUSLY ESTABLISHED SCHEDULES. AND WAGES CONTINUED HIGH OR ACTUALLY INCREASED UNDER ESCALATOR CLAUSES IN WAGE CONTRACTS.



THE NIXON ADMINISTRATION WAS OF COURSE CONCERNED ABOUT THE PERSISTENCE OF INFLATION. BUT IT ALSO WAS CONCERNED ABOUT PERSISTENT HIGH LEVELS OF UNEMPLOYMENT-- AND ABOUT STAYING IN OFFICE FOR A SECOND TERM. IN 1971 THE GOVERNMENT TURNED AGAIN TO DEFICIT FINANCING. AND IN 1972, THE FED BEGAN ALLOWING THE MONEY SUPPLY TO EXPAND RAPIDLY.

AGAIN, THE RATIONALE BEHIND THIS COURSE OF ACTION IS PERFECTLY UNDERSTANDABLE. THE POPULAR REACTION TO THE CREDIT CRUNCH OF 1969-70 HAD NOT BEEN FAVORABLE. THE VOTING PUBLIC HAD BEEN PARTICULARLY UNHAPPY ABOUT HIGH INTEREST RATES AND THE CURTAILMENT OF THE FLOW OF FUNDS FOR HOUSING.

BUT AGAIN, THE RESULTS OF THIS NEW COURSE OF ACTION WERE EQUALLY PREDICTABLE. DEFICIT SPENDING AND AN EXPANDING MONEY SUPPLY RENEWED PRESSURES ON PRICES. THE RESULTS WAS RENEWED INFLATION. FOREIGN EXCHANGE PROBLEMS BECAME MORE PRONOUNCED. INFLATION IN THE UNITED STATES PRICED MANY OF OUR COMMODITIES OUT OF THE FOREIGN MARKETS--AND HELPED LEAD TO A DEFICIT IN OUR TRADE BALANCE FOR THE FIRST TIME IN MANY YEARS.

OBVIOUSLY, I'VE LEFT OUT ONE MAJOR CHAPTER IN THIS BRIEF HISTORY OF THE CURRENT INFLATION IN THE UNITED STATES. THAT IS THE ADMINISTRATION'S WAGE AND PRICE CONTROLS PROGRAMS. WE'RE ALL AWARE THAT THEY WERE PUT INTO EFFECT IN AN ATTEMPT TO BREAK INFLATIONARY EXPECTATIONS AND THUS TO LIMIT PRICE INCREASES. SO I WON'T TAKE TIME FOR A DETAILED RECITAL OF HOW PHASES I, II, III, AND IV WORKED. I DO THINK IT'S WORTHWHILE, HOWEVER, TO TAKE



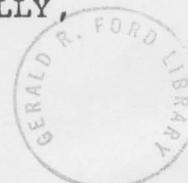
A LOOK AT WHAT WE'VE LEARNED FROM OUR EXPERIENCE UNDER THESE CONTROLS PROGRAMS OF THE PAST TWO YEARS. TO MY MIND, THERE ARE AT LEAST SIX POINTS TO BE NOTED. FIRST OF ALL, IT SEEMS OBVIOUS TO ME THAT PEOPLE WILL OBSERVE CONTROLS VOLUNTARILY FOR ONLY A LIMITED PERIOD OF TIME-- AND THEN ONLY WHEN THEY BELIEVE OTHERS ARE EQUALLY AFFECTED BY THE CONTROLS.

SECOND, OUR EXPERIENCE HAS PROVED BEYOND DOUBT THAT EFFECTIVE CONTROLS OF PRICES IN ONE SEGMENT OF THE ECONOMY LEAD SUCCESSIVELY TO CONTROLS IN OTHER PORTIONS OF THE ECONOMY.

THIRD, IT'S APPARENT THAT A MASSIVE BUREAUCRACY WOULD BE REQUIRED TO FORMULATE AND ENFORCE SUCH CONTROLS OVER MOST SEGMENTS OF THE ECONOMY. WITHOUT SUCH A BUREAUCRACY, THE CONTROLS SIMPLY CAN NOT BE ENFORCED. EVEN THEN, I BELIEVE THAT SUCH A BUREAUCRACY COULD NOT POSSIBLY ANTICIPATE ALL THE INTERRELATIONSHIPS BETWEEN ECONOMIC FORCES. AND I'M EQUALLY CERTAIN THAT UNEXPECTED PROBLEMS WOULD RESULTS FROM EVEN THE MOST THOROUGHLY RESEARCHED CONTROLS.

FOURTH, THE LAWS OF SUPPLY AND DEMAND CANNOT BE REPEALED BY GOVERNMENT EDICT. IF WE ARE NOT WILLING TO PAY A FAIR PRICE FOR CERTAIN GOODS, THOSE GOODS SIMPLY WILL NOT BE AVAILABLE. LOOK AT WHAT HAPPENED TO THE SUPPLY OF BEEF LAST SUMMER, WHEN THE GOVERNMENT TRIED TO LIMIT AN INCREASE IN PRICES.

FIFTH, I THINK WE'VE SEEN THAT WE CANNOT CONTROL EFFECTIVELY PRICES ON COMMODITIES PRODUCED MAINLY BY OTHER NATIONS. AND FINALLY,



OTHER NATIONS CANNOT BE ISOLATED FROM THE EFFECTS OF OUR OWN INFLATION. NOR ARE WE ISOLATED FROM THEIR ECONOMIC PROBLEMS.

BEYOND WHAT WE'VE LEARNED FROM THE RECENT CONTROLS PROGRAM, HOWEVER, I BELIEVE WE NEED TO LOOK CLOSELY AT OUR ENTIRE EXPERIENCE WITH INFLATION DURING THE PAST DECADE, BECAUSE IT ILLUSTRATES WELL WHAT I'VE BEEN SAYING THROUGHOUT THIS ENTIRE SPEECH.

FIRST OF ALL, OURS IS A POLITICAL AND AN ECONOMIC DEMOCRACY-- A SYSTEM WHICH WE DIRECT BY OUR OWN INDIVIDUAL CHOICES. WE HAVE RELATIVE FREEDOM TO MAKE THESE ECONOMIC CHOICES--BUT WE DONT HAVE FREEDOM FROM THE CONSEQUENCES OF OUR DECISIONS.

SECOND, WE LIVE IN AN ECONOMY OF SCARCITY. WE SIMPLY DON'T HAVE ENOUGH GOODS AND SERVICES TO SATISFY ALL OUR DESIRES. FURTHERMORE, AS A SOCIETY, WE CANNOT CONSUME MORE THAN WE PRODUCE OR HAVE SAVED OUT OF PAST PRODUCTION. THIS MEANS WE MUST ARRANGE OUR DESIRES AND NEEDS IN SOME ORDER OF PREFERENCE. WE MUST ESTABLISH PRIORITIES, LEST WE DISSIPATE OUR RESOURCES BY TRYING TO ATTAIN EVERYTHING AT ONCE--ONLY TO FIND WE HAVE GAINED THE LESS IMPORTANT AT THE SACRIFICE OF THE MORE IMPORTANT.

THIRD, OUR ECONOMIC SYSTEM IS AN EXTREMELY COMPLEX MACHINE FOR ALLOCATING RESOURCES. THE WORKINGS OF ONE PART OF THIS MACHINE INEVITABLY AFFECT MANY OTHER PARTS. OUR EXPERIENCE IN THE CURRENT INFLATION SHOWS THAT TRYING TO CONTROL ONE SEGMENT OF OUR ECONOMY



INVARIABLY LEADS TO EFFECTS SOMETIMES UNFORSEEN, IN OTHER SEGMENTS. PRICE SUPPORT PROGRAMS CAN LEAD TO SHORTAGES OF CERTAIN GOODS, WHICH IN TURN DRIVE UP PRICES, WHICH THEN LEAD THE GOVERNMENT TO ATTEMPT PRICE CONTROLS. PRICE LEVELS IN FOREIGN COUNTRIES AFFECT OUR BALANCE OF PAYMENTS, WHICH MAY MAKE IT NECESSARY TO DEVALUE OUR CURRENCY, WHICH IN TURN FUELS INFLATION. THESE COMPLEX INTERRELATIONSHIPS MEAN THERE ARE FEW EASY, QUICK, SIMPLE ANSWERS TO A SINGLE ECONOMIC PROBLEM. IT SIMPLY IS NOT ADVISABLE TO ATTACK ONE PROBLEM WITHOUT CONSIDERING THE POSSIBLE EFFECTS ON THE REST OF THE ECONOMY.

FINALLY, OUR POLITICAL AND ECONOMIC DEMOCRACY WON'T WORK EFFICIENTLY UNLESS WE ARE WELL INFORMED ABOUT THE NATURE, INTERRELATIONSHIPS, AND FUNCTIONS OF THE SYSTEM. IT'S ESPECIALLY IMPORTANT THAT WE AS BANKERS UNDERSTAND THE WORKINGS OF THE SYSTEM--AND EVEN MORE IMPORTANT, THAT WE WORK TO HELP OUR CUSTOMERS, OTHER FELLOW CITIZENS AND OUR POLITICAL LEADERS GAIN AN EQUALLY GOOD UNDERSTANDING. THEY ARE THE ONES WHO MAKE ECONOMIC DECISIONS IN THE POLITICAL ARENA THAT WILL HAVE A MAJOR IMPACT ON THE EFFECTIVE OPERATION OF OUR ECONOMY.

DO WE REALLY UNDERSTAND HOW THE SYSTEM WORKS? I THINK WE DO--IF WE TAKE THE TROUBLE TO UNDERSTAND THE LESSONS OF OUR EXPERIENCE DURING THE PAST TEN YEARS. AS MARK TWAIN SAID, EXPERIENCE IS A GREAT TEACHER, BUT YOU HAVE TO BE CAREFUL NOT TO LEARN MORE THAN



SHE ACTUALLY TEACHES. A CAT THAT SITS ON A HOT STOVE BURNER
WILL NEVER DO IT AGAIN. BUT SHE WON'T SIT ON A COLD STOVE EITHER.

WE AS BANKERS HAVE LEARNED A GREAT DEAL FROM OUR EXPERIENCE
DURING THE SIXTIES. THE QUESTION NOW IS WHETHER WE CAN PUT
THOSE LESSONS TO WORK IN MANAGING THE CHANGES THAT WILL CONFRONT
US IN THE MONTHS AND YEARS AHEAD. THAT IS THE CHALLENGE OF THE
SEVENTIES.



SPEECH HIGHLIGHTS

Capital Shortages In A Shortage Economy

Is there really a capital shortage in the United States? There certainly is -- and it seems to be getting worse. Industry, consumers and government are all increasing their demands on a limited pool of capital. And the supply of capital is simply not growing fast enough to meet all the demands. That in turn means we have a capital shortage.

Of course, in theory it's impossible to have a capital shortage in a freely competitive market economy. But we live in a political and economic democracy, where society and Congress have determined that interest rates simply will not be permitted to rise without restraint in some sectors of the economy. Hence, we have shortages of capital and our society has problems.

Consider the impact of capital shortages on the economy as a whole: greater economic instability. . .lower potential productivity. . .lower wages . . .recurring periods of inflation. . .potential loss of foreign trade.

Beyond the obvious problems of rising interest rates, however, the growing capital shortage will affect all of us in a much broader sense. With limited amounts of capital available to meet relatively unlimited demands, we must be very certain that our capital goes where it is needed most. And that means we as bankers and our society as a whole must set up some priorities.

For government, it means a choice: to continue deficit spending and thereby increase inflationary pressures; or to curtail some programs and allocate scarce capital to those who can use it most. . .a political judgment full of risk for the legislator.

What can we do to alleviate capital shortages? The ultimate solution is to restore and maintain a relatively stable, non-inflationary economy. And there are several ways to begin that restoration:

First, although not perfect, the competitive market system is still the most efficient system for allocating scarce resources. Insofar as politically feasible, it should operate freely, without restraints.

Second, the public and Congress need to recognize interest for what it is -- a price for use of loanable funds determined by forces of demand and supply. The government cannot control both price and quantity of any commodity or service at the same time.

Third, we must support fiscal and monetary policies that will tend to reduce inflation.



Finally, we must help the public and Congress understand the importance of all lending and investment activities, including commercial lending. We must promote a greater degree of economic literacy among bankers -- ourselves -- which must in turn be disseminated among the electorate and reflected in opinions expressed to legislators. All of us must look at the economy as a whole and consider the consequences of our actions (i.e., reactions in other parts of the economy) when we seek solutions to any economic problem.



CAPITAL SHORTAGES IN A SHORTAGE ECONOMY

**Remarks by Rex J. Morthland
President, American Bankers Association**

**Robert Morris Associates
Phoenix Arizona**

October 23, 1973



This is the time of year when leaves turn scarlet and economists sharpen their pencils in preparation for making economic forecasts. The crop of forecasts for 1974 share a dominant theme: The theme of shortages in major areas of the economy. After living through the first ten and half months of 1973, this should not come as a shock to anyone. The current energy shortage is a number one topic in Washington. For the first time since World War II, we face the prospect of rationing heating oil and other petroleum products this winter. And after years of paying farmers not to produce too much wheat or corn, among other agricultural products, we now are faced with a world-wide food shortage. To make matters worse, we're also running out of fertilizer.

All kinds of shortages are cropping up across the entire economic spectrum. For a few months this year, the Wall Street Journal was forced to cut down on its news coverage because of a nation-wide scarcity of newsprint. Housewives who make fruitcakes for Thanksgiving can't get any raisins. And let's hope that it's not a cold winter, because antifreeze is also in short supply.

There's one shortage, however, that never seems to make it into the headlines -- despite its significance for our economy. That is the overall shortage of capital, the grease that helps all the wheels in our economy turn. Those of us in banking are already quite familiar with capital shortages. They are now -- and will probably be for years to come -- a central factor in our banking decisions.

We all know that capital is accumulated by not consuming all goods that are produced. It is invested in either the form of equity capital or of borrowed capital. And we all know that business and industry are having problems attracting equity investment. But I think it's equally important to recognize there's a real shortage of that other form of capital -- the form bankers must deal with -- the funds we lend out to customers at interest.

For this reason, I want to talk with you briefly about these shortages -- to explore the demands that are creating them, to look at the supplies or sources of capital in this country, and finally to take a look at what we can do to alleviate the situation.



Is there really a capital shortage in the United States? There certainly is -- and it seems to be getting worse as shown by projections for capital spending by industry over the next few years.

Chase Manhattan economists predict that the domestic oil industry will require about \$200 billion by 1985. Power utilities will need about \$70 billion in outside capital in just the next five years. And one company alone -- AT&T -- estimates it will need \$40 to \$50 billion for modernization and expansion during the next decade. According to McGraw-Hill, capital outlays by all industry and business in the U.S. will approximate \$106 billion this year. The figure for 1985 is \$233 billion -- more than twice the 1973 total.

These are the traditional demands of industry for capital -- capital to replace obsolete equipment, to expand operations, and to increase production. Some of this demand traditionally has been met by equity investment. But I think we're all aware there are some serious problems in our equity markets. Stock issues have been curtailed greatly. In just the first six months of 1973, more than 300 offerings were withdrawn as unsalable.

The impact of this trend on commercial lending has been dramatic. Henry Kaufman, chief economist for Salomon Brothers, recently noted that bank loans to business have expanded nearly four times as fast this year as they did in 1969 -- another year when equity seemed to dry up. Obviously when business can't get capital in the equity markets and when bank loan rates are held below those in the unregulated sector of the money market, it steps up its demands on commercial lenders.

Nor is industry the only segment of our economy making increased demands on the nation's supply capital. In this, the so-called age of affluence, consumers are claiming their fair share too. They have been educated to expect a higher standard of living -- a standard of living dependent on high priced durables, such as automobiles and larger homes with air conditioning, dishwashers, disposals, sophisticated stereo equipment -- you know the list as well as I do.



Chief among the elements of this high standard of living is housing. In this country we have made it a national priority to make sure that every man, woman, and child has adequate shelter. And that means millions of new housing units. Building this housing will require a huge sum of money -- I doubt if anyone really knows exactly how much. The best projections from HUD indicate that we should be building around 2.5 million new units each year between now and 1980, if we want to meet the national housing goal. I think this estimate may be a little high. But the fact remains that millions of people do lack adequate housing. And we will need billions of dollars -- capital -- to build that housing and make it available to those who need it.

Government -- as well as industry and consumers -- are increasing their demands for capital because of the expanding role of government. The 1960's saw increasing activity by governments at all levels -- federal, state and local. We declared war on poverty, and our governments developed massive programs to carry on the combat. We fought racial prejudice -- another war that required new government programs and additional funding. We tackled the housing problem with special housing subsidy programs. We began a campaign to clean up our environment -- another laudable but expensive goal. We developed programs to provide health insurance for those over 65.

And it all cost a great deal of money. During the eight years between the Kennedy and Nixon inaugurations, the federal budget doubled. And more often than not, governments at all levels spent more money than they took in. Deficit spending was used to finance our nation's social programs when Congress would not increase tax

Of course, that money had to come from somewhere. It came from the money and capital markets. The government's new and expanded programs increased the demands on the national supply of capital -- they too helped add to our capital shortage.



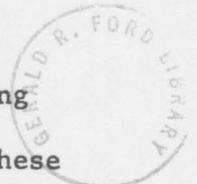
The cost of some of these programs can be felt all across the spectrum of the American economy. Our national pollution cleanup program is a good example. The initial cost of pollution control to the federal government was fairly minimal -- additional manpower to enforce the new environmental laws. But the actual cost of cleaning up -- and staying clean -- is incredibly high, particularly for industry. The steel industry alone predicts that it will have to spend up to \$4 billion per year over the next seven years for capital outlays including pollution control equipment, replacing obsolete facilities, and expanding capacity to meet the demands of an expanding economy.

Nor are pollution control costs confined to industry. They strike equally hard at state and municipal governments. According to the latest estimate from the Environmental Protection Agency, the nation must spend \$36 billion on treatment plants and new sewers for municipal sewage disposal. For complete sewage treatment -- including rehabilitation of existing sewers -- we would have to spend more than \$60 billion between now and 1990.

The consumer also helps bear the cost of this pollution cleanup. For example, new automobiles coming out of Detroit are equipped with devices that cut down on emission of air pollutants. They also make the cars less efficient -- and that means they consume more gasoline. In other words, these new devices add to the initial cost of your next car and they make it more expensive to run. This also increases the demand for gasoline, which adds to our current energy shortage.

Thus we see that the demands on our pool of capital are increasing every day. The next question then is: do we have enough capital to meet these demands?

Let's take a quick look at the traditional sources of capital in our economy. First of all, capital comes from the retained earnings and depreciation allowances of business and industry. In an expanding economy, however, these are not enough to meet all of business' investment needs. This may even be true for a stationary economy when a high rate of inflation eats away at the buying power of the dollar.



Capital also is generated by individual savings. After all, individuals as a class are the only net savers in our economy. Traditionally, they tend to save for high-cost items -- things such as putting their children through college, their own retirement, unforeseen emergencies, unemployment, and so forth. In the past they also have saved for major consumer durables, such as a house or a car.

But these motives no longer seem to be as strong. For one thing, governments now provide many of these items "free" or at a reduced cost, thereby reducing the necessity of saving. For example, the federal government provides a nation-wide pension plan through social security. It offers unemployment insurance protection to help those who lose their jobs. And for those even more unfortunate, welfare payments help tide them over until they get back on their feet. Medicaid and Medicare help defray part of their medical costs. And state education programs provide all the education opportunities one's children will ever need at a minimal cost to the consumer.

Furthermore, people seem to be more willing to borrow for major consumer purchases -- vacations, education, boats and so forth. The traditional Calvinist ethic is being replaced with the concept of "Pay as you enjoy" or even "Enjoy now, pay later."

Finally, potential savers realize that inflation eats away at the purchasing power of every dollar they save. In a period of inflationary expectations, consumers buy more today because they believe everything will be more expensive tomorrow.

All of these forces together mean only one thing: the supply of capital in this country is simply not growing fast enough to meet all the demands. And that in turn means a capital shortage.



Of course, it's theoretically impossible to have a capital shortage in a freely competitive market economy. According to economic theory, the solution to any capital shortage is simply to let interest rates rise to attract additional savings and at the same time to decrease the demand for capital. At some point, supply and demand will be brought into equilibrium and voila! No more capital shortage!

That's the theory. Reality is a little different. I'm sure I don't have to tell you we live in a political as well as an economic democracy. Society and Congress have determined that interest rates simply will not be permitted to rise without restraint in certain areas of the economy. One of those areas has been commercial loans by banks.

After our experience last spring, I think we're all aware what happens when the government attempts to restrain interest rates in only one segment of the market -- banking -- while the demand for capital is still increasing. Nevertheless, the fact remains that there's a tremendous amount of public sentiment against high interest rates. And that sentiment is reflected both in Congress and in the regulatory agencies. It takes the form of jawboning. And it manifests itself through statutory usury ceilings.

It all boils down to this. When capital becomes scarce, those of us in banking are going to have problems. The government will try to enforce lower interest rates than the market requires. The Committee on Interest and Dividends will go into action. And the inevitable result will be disintermediation from the regulated sector of the money market.



Beyond the obvious problems of rising interest rates, however, the growing capital shortage will affect all of us in a much broader sense. With limited amounts of capital available to meet relatively unlimited demands, we must be very certain that our capital goes where it is needed most. And that means we bankers and our society as a whole must set up some priorities.

Look at the impact of capital shortages on the economy as a whole. The overall effect is greater economic instability and lower potential productivity. This in turn means lower wages, combined with recurring periods of inflation. It means a potential loss of foreign trade, less foreign investment in our economy. It means an economy that's slowing down.

For government a capital shortage implies the necessity of choice. The government can choose to continue deficit spending to finance its programs and thereby increase inflationary pressures. Or it can choose to curtail some programs and to allocate scarce capital to those who can use it most effectively. That's a political judgement full of risk for the legislator.

For bankers the capital shortage implies even more difficult problems. As interest rates rise, we face the loss of our inventory of raw materials -- loanable funds -- to unregulated sectors of the money market -- a loss due to ceilings on bank interest rates paid on savings and time deposits.

For bankers, too, capital shortages imply difficult choices. How do we lend out our scarce funds most effectively? Do we allocate such resources on the basis of price, i.e. interest rates received on loans? Or do we base some of our lending decisions on social criteria, in effect lending at lower rates to help meet social problems? Should we reduce returns to one group of individuals -- savers -- to loan to other individuals -- borrowers -- at rates below the general market? We must make these decisions in such a way that we do not become a convenient whipping boy for the nation's economic problems.



Now the big question. What can we do to alleviate capital shortages?

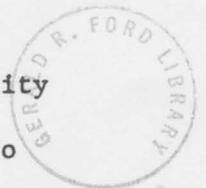
I don't have any simple answers. The ultimate solution, of course, is to restore and maintain a relatively stable, non-inflationary economy. This in turn requires that we recognize the limits of our resources -- and more, that we make sure we don't exceed those limits. That's the classic answer -- and I'm the first to admit it's easier said than done.

How we actually bring this economic miracle about is an entirely different matter. As I said before, there are no easy solutions. Nevertheless, I would like to offer a few suggestions as to how we can begin.

First, the competitive market system is the most efficient system I know of for allocating scarce resources. It's not perfect, but it's the best we have. I think we must work to allow that system to operate freely, without restraints, insofar as such free operations are politically feasible.

Of course, there are some flaws in the free market system. It doesn't always provide funds for pressing social needs. In such instances, we can use inducements to channel capital into these high priority areas. But such a system must be flexible and it must apply uniformly to all depository institutions -- regardless of whether it consists of tax credits or subsidies.

Second, I think we must continue to help the public and Congress recognize interest for what it is -- a price for use of loanable funds which is determined by forces of demand and supply. The rate can be held down by government fiat but all segments of the money market must be replaced if it is to be controlled. And even in this case we must expect a reduction in the amount of capital available. The government cannot control price and quantity at the same time. In a competitive free market economy, it makes no sense to place limitations on interest rates, such as those outlined in usury laws. Accordingly, we should work for the abolition of such laws.



Third, it's in your interest--indeed, in the interest of all segments of our economy -- to support fiscal and monetary policies that will tend to reduce inflation. On balance higher interest rates are caused by inflation rather than being causes of inflation.

Finally, I think we must help the public--and Congress--understand the importance of lending and investment activities. A good many other-wise well educated people tend to assume that consumer lending and social priority lending are more important than day-to-day business loans for example. I certainly would agree that loans for housing or education are indeed worthwhile. But it's important to understand one basic economic fact of life: all these other loan activities depend on a healthy economy. And a healthy economy depends in turn on a healthy level of business loans and investment.

Let me give an example. Housing certainly is a high priority area in our society. Banks do make a substantial amount of residential loans and also finance construction. But look beyond mortgage instruments themselves and consider what goes into a house--plumbing, lumber, bricks, insulation--the list goes on and on. Who produces these building materials? Industry. And who provides a good deal of the capital for investment in industry? The answer is obvious.

Furthermore we own substantial amounts of municipal bonds that make community development possible. At the end of last year, banks had an estimated \$60 billion invested in municipal bonds--bonds to pay for roads, for sewers, for schools, for police buildings--all the necessary physical facilities that make a community of homes possible.



But that's not the major point. That point is that a healthy level of capital investment in business and industry is a necessary prerequisite for a healthy, productive capitalist economy. Without such investment, few other demands can be met.

It's a point worth remembering as we move into this new economic era, when shortages may be the dominant characteristic of our economy. Certainly it's a point to be noted when we make the choices that will allocate our relatively scarce pool of capital--because these shortages are real. The demand for capital is growing every day. And the supply of capital simply is not keeping pace--at least not in our current overheated, inflationary economy even though current interest rates are high by historical standards. How we deal with these capital shortages--and the choices we make--may well shape the future of our industry--and our economy--during the last third of this century.





THE AMERICAN BANKERS ASSOCIATION 1120 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20036

FEDERAL AGENCY RELATIONS

FEDERAL ADMINISTRATIVE ADVISER

HAMPTON A. RABON

202/467-4200

April 3, 1974

Mrs. Catherine Mallardi
Secretary to Chairman Burns
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Mrs. Mallardi:

There is enclosed for your information a copy of the agenda for the next meeting of the Government Borrowing Committee. Please call to Chairman Burns' attention that the Committee will be meeting in our offices at 1120 Connecticut Avenue, N.W. The building (Bender) has another entrance on L Street, near 18th. Our Board Room is on the 7th floor.

The Committee will look forward, as usual, to meeting with Chairman Burns at 4:00 p.m. on Tuesday, April 30, 1974.

I am also enclosing for Chairman Burns' information a list of the members of the Government Borrowing Committee.

Sincerely,

Hampton A. Rabon

HAR:fm
Enclosures



ATB
attended
AM

AGENDA
GOVERNMENT BORROWING COMMITTEE
The American Bankers Association
April 30-May 1, 1974

Tuesday, April 30, 1974

9:15 a.m.	Committee meets in Board Room of The American Bankers Association 1120 Connecticut Avenue, N.W. (7th Floor) <u>1/</u>
10:00 a.m.	Committee to review slides in Room 2334 of the Treasury building <u>2/</u>
11:00 a.m.	Committee to meet with Under Secretary for Monetary Affairs, Mr. Paul Volcker, in Room 4426 of the Treasury building for backgrounding <u>3/</u>
12:30 p.m. 1:00 p.m.	Refreshments Luncheon. Chinese Room, Mayflower Hotel
2:30 p.m.	Committee to assemble in Board Room of The American Bankers Association 1120 Connecticut Avenue, N.W. (7th Floor) <u>1/</u> Chairman Burns (Federal Reserve Board) will meet with the Committee at 4:00 p.m.
6:00 p.m. 7:00 p.m.	Reception Dinner. Cabinet and Pan American Rooms, Mayflower Hotel

Wednesday, May 1, 1974

9:00 a.m.	Committee to assemble in Board Room of The American Bankers Association 1120 Connecticut Avenue, N.W. (7th Floor) <u>1/</u>
9:45 a.m.	Committee to report its recommendations to Secretary Shultz and the Treasury Financing Group in Room 4426 of the Treasury building <u>3/</u>

- 1/ This location is on Connecticut Avenue across from the Mayflower Hotel.
- 2/ Treasury will use the regular projection room on the second floor in the southwest corner of the building (corner facing the Mall and the White House)
- 3/ Conference with Under Secretary for Monetary Affairs and report to the Secretary of the Treasury will be held in the 4th floor Conference Room on west side of the building near the center elevators opposite the White House.



GOVERNMENT BORROWING COMMITTEE

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Chairman and Chief Executive Officer
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President
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D. Thomas Trigg
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(Past President, ABA)

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Washington, D.C. 20036

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President
American Security and Trust Company
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Washington, D.C. 20013
(Chairman, ABA Savings Bonds Committee)

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The Peoples Bank and Trust Company of Selma
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(President, ABA)

George L. Whyel
Vice Chairman of the Board
Genesee Merchants Bank and Trust Company
Flint, Michigan 48502
(President-Elect, ABA)

ABA Staff:

Hampton A. Rabon
Director (202-467-4200)

Lawrence Banyas
Economic Consultant (202-467-4382)



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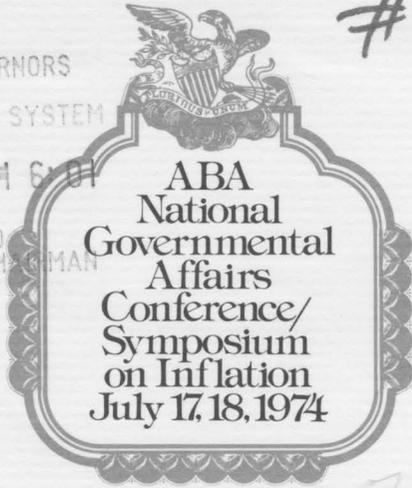
J. MORTHLAND
Chairman of the Board
The Peoples Bank and Trust Company
Selma, Alabama
President, The American
Bankers Association

GABRIEL HAUGE
Chairman of the Board
Manufacturers Hanover Trust
New York, New York
Chairman, ABA Symposium
on Inflation

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1974 JUN 10 PM 6:01

RECEIVED
OFFICE OF THE CHAIRMAN



EUGENE H. ADAMS
Chairman of the Board
The First National Bank of Denver
Denver, Colorado
Chairman, ABA Governing Council

FRANK E. BAUDER
Chairman of the Board
and Chief Executive Officer
Central National Bank
Chicago, Illinois

Chairman, ABA Government
Relations Council

June 7, 1974

The Honorable Arthur F. Burns
Chairman
Board of Governors of the
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Chairman Burns:

On behalf of the American Bankers Association, I would like to invite you to the National Governmental Affairs Conference and Symposium on Inflation which will be held July 17 and 18 at the Washington Hilton Hotel, Washington, D.C.

The July 17 program will focus attention on perspectives of the financial industries regarding changes in structure and powers, the relationship of trade associations to the legislative process, competing financial institutions' views of the marketplace, as well as some insights into the current Washington scene. That evening, a reception honoring all Members of Congress will be held.

The following day, July 18, you will be joined by other key representatives of business, government, academia, and labor from all over the nation for a Symposium on Inflation. We feel there is an urgent need to bring together the best-qualified authorities on our nation's economy and key leaders of the major economic groups in our society for a discussion on the serious national problem caused by inflation. It is our hope and belief that, through this dialogue of diverse interests, a reasonable and realistic consensus for action can be derived.

A glance at the names of the speakers and topics listed on the enclosed program clearly reflects that these sessions will provide participants with meaningful information on many timely and important issues. Anticipating your interest in these sessions, I am enclosing a complimentary registration. If you plan on attending, please return it to us in the enclosed envelope.

Looking forward to seeing you on July 17 and 18.

Sincerely,

Gerald M. Lowrie
Executive Director
Government Relations



AFB did not attend called 6/12/74 uncertain cm

467-4097 Helen McAnulty



THE ABA NATIONAL
GOVERNMENTAL
AFFAIRS CONFERENCE/
SYMPOSIUM ON INFLATION
JULY 17, 18, 1974

Washington Hilton Hotel,
Washington, D. C.

THE ABA
SYMPOSIUM
ON INFLATION



Program Committee

Chairman:

EDWIN H. YEO, III
Vice Chairman
Pittsburgh National Bank
Pittsburgh, Pennsylvania

WILLIAM F. FORD
Executive Director and Chief Economist
American Bankers Association
Washington, D. C.

TILFORD C. GAINES
Senior Vice President
Manufacturers Hanover Trust Company
New York, New York

ALAN GREENSPAN
President
Townsend-Greenspan & Co., Inc.
New York, New York

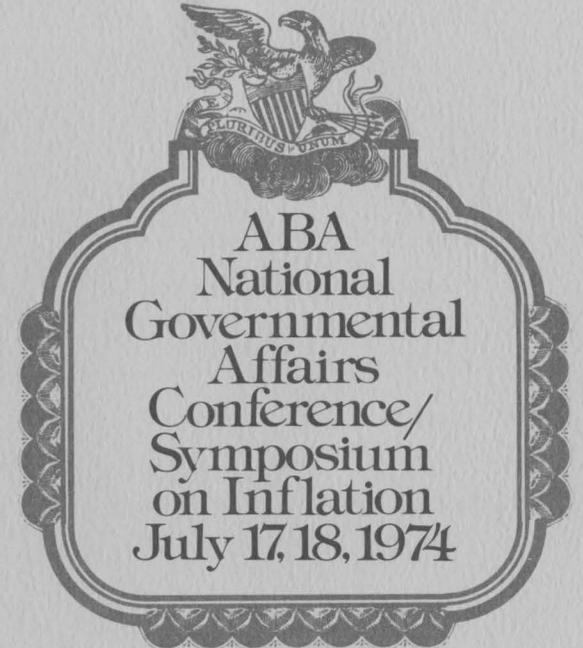
SAUL B. KLAMAN
Vice President & Chief Economist
National Association of Mutual Savings
Banks
New York, New York

LEIF H. OLSEN
Senior Vice President
First National City Bank
New York, New York

Ex Officio Members:

WILLIS W. ALEXANDER
Executive Vice President
American Bankers Association
Washington, D. C.

GABRIEL HAUGE
Chairman of the Board
Manufacturers Hanover Trust Company
New York, New York



THE AMERICAN BANKERS ASSOCIATION

1120 CONNECTICUT AVENUE, N.W. WASHINGTON, D. C. 20036



WEDNESDAY, July 17

7:30 a.m.-5:00 p.m.

REGISTRATION

9:00 a.m.-12:00 p.m.

GENERAL SESSION

Welcome

EUGENE H. ADAMS

Chairman, The First National Bank of Denver
Denver, Colorado
Chairman, ABA Governing Council

Opening Remarks and Introductions

REX J. MORTHLAND

Chairman, The Peoples Bank & Trust Company
Selma, Alabama
President, The American Bankers Association

*"Communicating Your Message
in a Representative Democracy"*

THE HONORABLE BARBER B. CONABLE, JR.
United States House of Representatives

*"Financial Institutions
and the Public Interest"*

THE HONORABLE THOMAS J. McINTYRE
United States Senate

Panel Session:

*"Depository Institutions –
Present Concerns/Future Opportunities"*

PANELISTS:

WILLIS W. ALEXANDER

Executive Vice President
The American Bankers Association

GROVER W. ENSLEY

Executive Vice President
National Association of Mutual Savings Banks

NORMAN B. STRUNK

Executive Vice President
United States League of Savings Associations

12:00-12:30 p.m.

RECEPTION FOR REGISTRANTS

12:30-2:00 p.m.

LUNCHEON FOR REGISTRANTS

"The Nature of Leadership"

HUGH SIDNEY

Chief, Time-Life News Service,
Washington, D. C.

6:00-8:00 p.m.

CONGRESSIONAL RECEPTION

There will be special activities
planned for the spouses during the day.



THURSDAY, July 18

7:30-8:45 a.m.

Continental Breakfast

REGISTRATION

9:00-12:00 noon

GENERAL SESSION

Welcoming Remarks

REX J. MORTHLAND

Chairman, The Peoples Bank & Trust Company,
Selma, Alabama;
President, The American Bankers Association

"Why We're Here"

GABRIEL HAUGE

Chairman, Manufacturers Hanover Trust,
New York, New York;
Chairman, ABA Symposium on Inflation

"The Problem"

THE HONORABLE HENRY C. WALLICH
Member, Board of Governors of the
Federal Reserve System

"The Program"

PAUL McCracken

Professor, Graduate School
of Business Administration,
University of Michigan,
Ann Arbor, Michigan

Panel Discussion:

"The Reaction"

MODERATOR:

EDWIN H. YEO, III

Vice Chairman, Pittsburgh National Bank,
Pittsburgh, Pennsylvania;
Program Chairman,
ABA Symposium on Inflation

PANELISTS:
I. W. ABEL
President
United Steelworkers of America

CHARLES L. SCHULTZE
Senior Fellow
The Brookings Institution

ALAN GREENSPAN
President
Townsend-Greenspan & Company, Inc.,
New York, New York

A BUSINESS EXECUTIVE

12:00-12:30 p.m.
RECEPTION FOR REGISTRANTS

12:30-2:00 p.m.
LUNCHEON FOR REGISTRANTS

PRESIDING:

GABRIEL HAUGE

SPEAKER:

THE HONORABLE WILLIAM E. SIMON
Secretary of the Treasury

2:15-4:00 p.m.
GENERAL SESSION

Panel Discussion:

"The Action: Can We Do It?"

PANELISTS:

ROBERT L. BARTLEY

Editorial Page Editor
Wall Street Journal, New York, New York

THE HONORABLE BOB PACKWOOD
United States Senate

THE HONORABLE KENNETH RUSH
Counsellor to the President
for Economic Policy

**A MEMBER OF THE UNITED STATES
HOUSE OF REPRESENTATIVES**

"Summary and Appraisal"

PAUL McCracken

4:00 p.m.
ADJOURNMENT

*Joe
Simon*



THE AMERICAN BANKERS ASSOCIATION 1120 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20036

FEDERAL AGENCY RELATIONS

FEDERAL ADMINISTRATIVE ADVISER

HAMPTON A. RABON

202/467-4200

June 19, 1974

Mrs. Catherine Mallardi
Secretary to Chairman Burns
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Mrs. Mallardi:

There is enclosed for your information a copy of the agenda for the next meeting of the Government Borrowing Committee. Please call to Chairman Burns' attention that the Committee will be meeting in our offices at 1120 Connecticut Avenue, N.W. The building (Bender) has another entrance on L Street, near 18th. Our Board Room is on the 7th floor.

The Committee will look forward, as usual, to meeting with Chairman Burns at 4:00 p.m. on Tuesday, July 30, 1974.

I am also enclosing for Chairman Burns' information a list of the members of the Government Borrowing Committee.

Sincerely,

Hampton A. Rabon

HAR: fmm
Enclosures

ATB attended
am
GERALD R. FORD LIBRARY

AGENDA
GOVERNMENT BORROWING COMMITTEE
The American Bankers Association
July 30-31, 1974

Tuesday, July 30, 1974

9:15 a.m.	Committee meets in Board Room of The American Bankers Association 1120 Connecticut Avenue, N.W. (7th Floor)	<u>1/</u>
10:00 a.m.	Committee to review slides in Room 2334 of the Treasury building	<u>2/</u>
11:00 a.m.	Committee to meet with Under Secretary for Monetary Affairs, Mr. Jack Bennett, in Room 4426 of the Treasury building for backgrounding	<u>3/</u>
12:30 p.m.	Refreshments	
1:00 p.m.	Luncheon. Chinese Room, Mayflower Hotel	
2:30 p.m.	Committee to assemble in Board Room of The American Bankers Association 1120 Connecticut Avenue, N.W. (7th Floor) <u>1/</u> Chairman Burns (Federal Reserve Board) will meet with the Committee at 4:00 p.m.	
6:00 p.m.	Reception	
7:00 p.m.	Dinner. Pan American Room, Mayflower Hotel	

Wednesday, July 31, 1974

9:00 a.m.	Committee to assemble in Board Room of The American Bankers Association 1120 Connecticut Avenue, N.W. (7th Floor) <u>1/</u>	
9:45 a.m.	Committee to report its recommendations to Secretary Simon and the Treasury Financing Group in Room 4426 of the Treasury building <u>3/</u>	

- 1/ This location is on Connecticut Avenue across from the Mayflower Hotel.
- 2/ Treasury will use the regular projection room on the second floor in the southwest corner of the building (corner facing the Mall and the White House)
- 3/ Conference with Under Secretary for Monetary Affairs and report to the Secretary of the Treasury will be held in the 4th floor Conference Room on west side of the building near the center elevators opposite the White House.



GOVERNMENT BORROWING COMMITTEE

Chairman: Robert M. Surdam
Chairman and Chief Executive Officer
National Bank of Detroit
RPA Box 116
Detroit, Michigan 48232

Andrew Benedict
Chairman of the Board
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Nashville, Tennessee 37237

Alfred Brittain III
President
Bankers Trust Company
P.O. Box 318, Church Street Station
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Robert E. Bryans
Chairman and President
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President
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President and Chief Executive Officer
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Richard P. Cooley
President and Chief Executive Officer
Wells Fargo Bank, N.A.
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San Francisco, California 94144

Gaylord Freeman
Chairman of the Board
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Chicago, Illinois 60670

Robert J. Gaddy
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St. Louis, Missouri 63118

William M. Jenkins
Chairman
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Ben F. Love
Chairman and Chief Executive Officer
Texas Commerce Bank, N.A.
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Houston, Texas 77001

C. Coleman McGehee
Chairman and Chief Executive Officer
First and Merchants National Bank
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John A. Moorhead
Senior Chairman of the Board
Northwestern National Bank
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Minneapolis, Minnesota 55480

Ellmore C. Patterson
Chairman of the Board
Morgan Guaranty Trust Company
23 Wall Street
New York, New York 10015

John H. Perkins
President
Continental Illinois National Bank and Trust Co.
231 South LaSalle Street
Chicago, Illinois 60693



Government Borrowing Committee

Howard C. Petersen
Chairman of the Board
The Fidelity Bank
Broad and Walnut Streets
Philadelphia, Pennsylvania 19109

Robert V. Roosa
Partner
Brown Brothers Harriman & Company
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New York, New York 10005

D. Thomas Trigg
Chairman and Chief Executive Officer
National Shawmut Bank of Boston
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Boston, Massachusetts 02106

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Executive Vice President
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Chicago, Illinois 60693

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(Past President, ABA)

Willis W. Alexander
Executive Vice President
The American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

W. Jarvis Moody
President
American Security and Trust Company
15th and Pennsylvania Avenue, N.W.
Washington, D.C. 20013
(Chairman, ABA Savings Bonds Committee)

Rex J. Morthland
Chairman of the Board
The Peoples Bank and Trust Company of Selma
P.O. Box 799
Selma, Alabama 36701
(President, ABA)

George L. Whyel
Vice Chairman of the Board
Genesee Merchants Bank and Trust Company
Flint, Michigan 48502
(President-Elect, ABA)

ABA Staff:

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Economic Consultant (202-467-4382)

Gerald M. Lowrie, Executive Director
Government Relations (202-467-4097)

William F. Ford, Executive Director
Research and Planning (202-467-4018)



nc
B

THE AMERICAN BANKERS ASSOCIATION 1120 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20036

FEDERAL AGENCY RELATIONS

FEDERAL ADMINISTRATIVE ADVISER
HAMPTON A. RABON
202/467-4200

September 30, 1974

Mrs. Catherine Mallardi
Secretary to Chairman Burns
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1974 OCT -1 PM 1:01

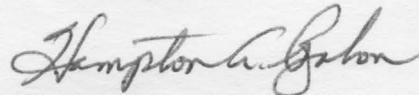
RECEIVED
OFFICE OF THE CHAIRMAN

Dear Mrs. Mallardi:

There is enclosed for your information a copy of the agenda for the next meeting of the Government Borrowing Committee. Please call to Chairman Burns' attention that the Committee will be meeting in our offices at 1120 Connecticut Avenue, N. W. The building (Bender) has another entrance on L Street, near 18th. Our Board Room is on the 7th floor.

The Committee will look forward, as usual, to meeting with Chairman Burns at 4:00 p.m. on Tuesday, October 29, 1974.

Sincerely,



Hampton A. Rabon

HAR/rh
encl.



AGENDA
GOVERNMENT BORROWING COMMITTEE
The American Bankers Association
October 29-30, 1974

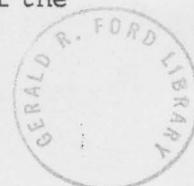
Tuesday, October 29, 1974

9:15 a.m.	Committee meets in Board Room of The American Bankers Association 1120 Connecticut Avenue, N. W. (7th Floor)	<u>1/</u>
10:00 a.m.	Committee to review slides in Room 2334 of the Treasury building	<u>2/</u>
11:00 a.m.	Committee to meet with Under Secretary for Monetary Affairs, Mr. Jack Bennett, in Room 4426 of the Treasury building for backgrounding	<u>3/</u>
12:30 p.m.	Refreshments	<u>4/</u>
1:00 p.m.	Luncheon	<u>4/</u>
2:30 p.m.	Committee to assemble in Board Room of The American Bankers Association 1120 Connecticut Avenue, N. W. (7th Floor) Chairman Burns (Federal Reserve Board) will meet with the Committee at 4:00 p.m.	<u>1/</u>
6:00 p.m.	Reception	<u>4/</u>
7:00 p.m.	Dinner	<u>4/</u>

Wednesday, October 30, 1974

9:00 a.m.	Committee to assemble in Board Room of The American Bankers Association 1120 Connecticut Avenue, N. W. (7th Floor)	<u>1/</u>
9:45 a.m.	Committee to report its recommendations to Secretary Simon and the Treasury Financing Group in Room 4426 of the Treasury building	<u>3/</u>

- 1/ This location is on Connecticut Avenue across from the Mayflower Hotel.
- 2/ Treasury will use the regular projection room on the second floor in the southwest corner of the building (corner facing the Mall and the White House).
- 3/ Conference with Under Secretary for Monetary Affairs and report of the Secretary of the Treasury will be held in the 4th floor Conference Room on west side of the building near the center elevators opposite the White House.
- 4/ Place to be announced at a later date.



WILLIS ALEXANDER

Date September 11, 1974

Dr. Burns -

The enclosed report was delivered by first class mail to the desk of the chief executive officer of 13,800 banks as the Association's initial step in enlisting their active participation in the national war on inflation.

The responses are most encouraging.



THE AMERICAN BANKERS ASSOCIATION



Executive Report

September 4, 1974

Good Morning!

Neither you nor I can cure inflation in the next seven days, but together we can make a start.

The American Bankers Association has been invited by the President to participate in the Economic Summit September 27-28, and we need your help.

As you know, the Summit will be preceded by a number of specialized sessions to consider the facets of the primary problem. The ABA has been asked to participate in three of these, and by the time you read this, the first will be scarcely a week away.

On September 12, a meeting in Atlanta will consider the difficulties connected with housing and construction. On the 13th, we will participate in a Chicago session on the problems of agriculture. Washington will be the site on the 20th when the subject will be banking and finance.

To participate effectively, ABA officers need your assistance.

At the request of Rex Morthland, I urge you to meet immediately with your officers and directors for the purpose of developing ideas that may contribute to the solution of the inflationary problem. While no idea should be prematurely discarded, it may serve to focus your thinking if you consider some of the suggestions already made, and try to assess their impact on your customers and your community. Among these are:

- Methods for increasing the flow of funds to savings, including the possibility of relief from taxation on the first \$1,000 worth of interest on savings or dividends on stock;
- A variable-rate Certificate of Deposit coupled with a program aimed at eliminating usury statutes; and
- Assistance to housing either through tax incentives to lenders, direct subsidies to buyers, or subsidies to thrift institutions.

Obviously, these only scratch the surface, but they are all possibilities that have been brought to public attention. As recognized community leaders, we must be credible in what we say and do. As you

Route to:

BOARD OF GOVERNORS
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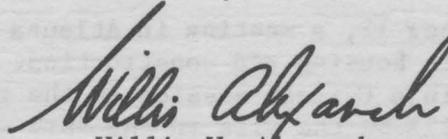
make suggestions, do not overlook steps you and your bank can take to make this crusade succeed.

Let me repeat that we are anxious to hear your reactions to proposals already being aired, and to record any ideas that your discussions may generate. The ABA's Economic Advisory Committee -- assisted by the staff -- is prepared to read, analyze and consolidate this material in order to reflect your thinking in this series of important meetings.

I believe we should also keep in mind that while there is an economic basis for inflation, its cure may result in large part from a blunting of the inflationary expectations to which we have all fallen prey. Reversing this psychological element in the equation may prove the greatest challenge of all.

Clearly, time is our greatest enemy in this effort. As you read this, our first opportunity to contribute may be only a week away. Others will follow shortly thereafter. I urge that you react with all possible speed. America stands in need of your expertise and support.

Sincerely,



Willis W. Alexander

P.S. Please route your replies directly to me. I'll see to it they get immediate attention.



THE AMERICAN BANKERS ASSOCIATION 1120 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20036

FEDERAL AGENCY RELATIONS

FEDERAL ADMINISTRATIVE ADVISER

HAMPTON A. RABON
202/467-4200

December 19, 1974

Mrs. Catherine Mallardi
Secretary to Chairman Burns
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

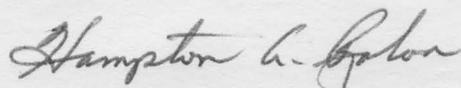
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The Committee will look forward, as usual, to meeting with Chairman Burns at 4:00 p.m. on Tuesday, January 21, 1975.

I am also enclosing for Chairman Burns' information a list of the members of the Government Borrowing Committee.

Sincerely,



Hampton A. Rabon

HAR/rh
encl.



AGENDA
GOVERNMENT BORROWING COMMITTEE
The American Bankers Association
January 21-22, 1975

Tuesday, January 21, 1975

9:15 a.m.	Committee meets in Board Room of The American Bankers Association 1120 Connecticut Avenue, N. W. (7th Floor)	<u>1/</u>
10:00 a.m.	Committee to review slides in Room 2334 of the Treasury building	<u>2/</u>
11:00 a.m.	Committee to meet with Under Secretary for Monetary Affairs, Mr. Jack Bennett, in Room 4426 of the Treasury building for backgrounding	<u>3/</u>
12:30 p.m.	Refreshments	<u>4/</u>
1:00 p.m.	Luncheon	<u>4/</u>
2:30 p.m.	Committee to assemble in Board Room of The American Bankers Association. Chairman Burns (Federal Reserve Board) will meet with the Committee at 4:00 p.m.	<u>1/</u>
6:00 p.m.	Reception	<u>4/</u>
7:00 p.m.	Dinner	<u>4/</u>

Wednesday, January 22, 1974

9:15 a.m.	Committee to assemble in Board Room of The American Bankers Association	<u>1/</u>
10:00 a.m.	Committee to report its recommendations to Secretary Simon and the Treasury Financing Group in Room 4426 of the Treasury building	<u>3/</u>

- 1/ This location is on Connecticut Avenue across from the Mayflower Hotel.
2/ Treasury will use the regular projection room on the second floor in the southwest corner of the building (corner facing the Mall and the White House).
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4/ Place to be announced at a later date.



GOVERNMENT BORROWING COMMITTEE

Chairman: Robert M. Surdam
Chairman and Chief Executive Officer
National Bank of Detroit
RPA Box 116
Detroit, Michigan 48232

Andrew Benedict
Chairman of the Board
First American National Bank
P.O. Box 1351
Nashville, Tennessee 37237

Gaylord Freeman
Chairman of the Board
The First National Bank
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Henry G. Blanchard
Chairman of the Board
Commercial National Bank of Kansas City
P.O. Box 1400
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Gabriel Hauge
Chairman of the Board
Manufacturers Hanover Trust
350 Park Avenue
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Alfred Brittain III
President
Bankers Trust Company
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New York, New York 10015

William M. Jenkins
Chairman
Seattle-First National Bank
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Robert E. Bryans
Chairman and President
First National Bank of Casper
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Ben F. Love
Chairman and Chief Executive Officer
Texas Commerce Bank, N.A.
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Willard C. Butcher
President
The Chase Manhattan Bank, N.A.
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Minneapolis, Minnesota 55480

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Ellmore C. Patterson
Chairman of the Board
Morgan Guaranty Trust Company
23 Wall Street
New York, New York 10015



Government Borrowing Committee

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President
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Chicago, Illinois 60693

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Executive Vice President
The American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Howard C. Petersen
Chairman of the Board
The Fidelity Bank
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Philadelphia, Pennsylvania 19109

J. Rex Duwe
President and Chairman
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(President-Elect, ABA)

D. Thomas Trigg
Chairman and Chief Executive Officer
National Shawmut Bank of Boston
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(Chairman, ABA Savings Bonds Committee)

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(Past President, ABA)

Donald C. Miller
Executive Vice President
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Gerald M. Lowrie, Executive Director
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