August 11, 1944

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

Dear Mr. Secretary:

I am enclosing a memorandum that discusses the results of the Fifth War Loan Drive and suggests for consideration various measures for improving the situation during the Sixth and succeeding drives. This memorandum has been prepared following a full discussion by the Executive Committee at its meeting held on July 28 and further telephone discussion since that time.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure

LMP:MSE/mhe

August 11, 1944

Honorable Daniel W. Bell,
Under Secretary of the Treasury,
Washington, D. C.

Dear Dan:

I am enclosing a copy of a memorandum sent to the Secretary today. This memorandum discusses the results of the Fifth War Loan Drive and suggests for consideration various measures for improving the situation during the Sixth and succeeding drives. It is the memorandum that I said some time ago that the Executive Committee would prepare.

Sincerely yours,

M. S. Eccles,
Chairman

Enclosure

LMP/MSE:mhe

STRICTLY CONFIDENTIAL

MEMORANDUM FROM THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE TO THE SECRETARY OF THE TREASURY

The Executive Committee of the Federal Open Market Committee, at its meeting held on July 28, 1944, discussed the results of the Fifth War Loan Drive, giving particular attention to suggestions that might be made for further improvement in performance during the Sixth and succeeding drives. While recognizing the substantial accomplishments in increasing sales of Government securities to nonbank investors since the First War Loan Drive in December 1942, the Committee is concerned about the large expansion in bank credit, the growth in speculative purchases, and the methods of indirect purchases of securities by banks that accompanied the recent drive. It is feared that these developments, which no doubt were profitable to those who evaded the rules, will lead to further evasion in the future, unless some simple and definite yardstick is provided for limiting subscriptions that can be applied when subscriptions are initiated. Under conditions that existed during the past drive, the Reserve Banks had no basis, except in the case of dealers and brokers, by which to impose effective and uniform policing of subscriptions and had to rely primarily on the commercial banks, inasmuch as the only subscriptions subject to policing were those that involved bank loans. It is the opinion of the Committee, therefore, that additional steps should be taken to curb undesirable practices and to increase the pressure for sales to nonbank investors, to the end that the proportion of the debt going to the banking system, particularly indirectly, may be further reduced.

At weekly reporting member banks, total loans on and investments in Government securities between June 7, the reporting date preceding the drive, and July 12, the reporting date following the drive, increased by 6.7 billion dollars. This total comprised 4.9 billion dollars of purchases of Government securities, 546 million of loans on Government securities to brokers and dealers, and 1.3 billion of loans on Government securities to others. A substantial part of the increase in bank investments and of the loans on Government securities to brokers and dealers represented securities that were sold in the market by nonbank investors desiring to increase their subscriptions in the drive. A considerable part of the loans on Government securities to others represented subscriptions that were made for the purpose of quick resale or to carry at a profit. In addition, there is evidence that a number of banks arranged with their customers, officers, directors, or affiliated corporations to place subscriptions during the drive, with the understanding that after the drive the banks would purchase the securities thus obtained. The loans that made possible these latter transactions are in direct contravention of the Treasury's request with respect to bank loans for the purchase of securities during the drive.

While no data are available as to the exact extent of these speculative and indirect purchases, it is evident from the figures of reporting member banks and from reports of sales in certain categories that such purchases were not only widespread but reached exaggerated proportions in certain localities. In eight States, sales of Series E bonds ranged between 83 and 121 per cent of quotas, but sales of other securities to individuals, partnerships, and personal trust accounts were disproportionately large, reaching more than three times the quota in Georgia and between two and three times the quotas in Alabama, Florida, Kentucky, Maryland, Mississippi, Oregon, and Tennessee. Such comparisons, together with knowledge of practices carried on in certain cities, created much dissatisfaction on the part of bankers and other members of the War Finance Committee organization and so impaired the usefulness of quotas.

Bankers who respected the Treasury's request and made no speculative loans and no special subscription arrangements with their customers or with others feel that they were placed at an unfair disadvantage in relation to their competitors who engaged in such practices. They resent purchasing securities at a premium from speculators when their competitors by virtue of prior arrangements have obtained the interest on loans, obtained the use of war loan deposits, and purchased the securities at or near par. Unless the Treasury takes strong steps to eradicate such practices, it is likely that other banks will follow them in the next drive, and sales organizations in communities that reached their quotas the hard but the sound way may be tempted to adopt the easier method. Few bankers would object to restrictive measures if they were satisfied that these measures were being applied uniformly.

With this background in mind, the Executive Committee suggests consideration of the following measures to improve the situation:

1. That the Treasury appeal more strongly than heretofore for the whole-hearted cooperation of commercial banks in complying with Treasury wishes regarding loans on securities offered in the next drive and that the Treasury at the same time condemn the undesirable practices that developed during the Fifth War Loan Drive and indicate that in the future any subscriptions not entered in accordance with the Treasury's request will be subject to rejection.

2. That subscribers for market issues, other than brokers and dealers, be required to make a down payment of 25 per cent of their subscriptions from existing funds when entering subscriptions that involve bank loans. Policing of subscriptions from investors, other than brokers and dealers, by the Federal Reserve Banks is probably physically impossible because of their volume and timing when the drive technique is used. The only practical way to police or limit them, therefore, is at the commercial banks before they are entered and paid for. This method in any case would cause the least resentment. Since it is only those subscriptions involving bank loans that are subject to policing, it is the feeling of the Committee that the requirement of 25 per cent down payment will serve naturally to reduce speculative subscriptions and to bring about uniform action by the banks in all parts of the country. In this connection, banks should be required to certify on the subscription form that at least 25 per cent of the amount of each subscription has been paid in cash without borrowing from the certifying bank for the purpose and that they have no beneficial interest in such subscriptions.

3. That the Treasury again request the Reserve Banks to police subscriptions from brokers and dealers and that the Treasury provide a more specific yardstick, one that can be readily understood and uniformly applied.

4. That a partial-payment plan be inaugurated and the lowest denomination of marketable bonds be reduced from $500 to $100 in an attempt to increase subscriptions from permanent investors. These measures would also reduce the demand for securities between the drives and meet the reported demand from an increasing number of investors who would prefer to purchase marketable bonds rather than add further to their holdings or regular current purchases of Series E bonds.

5. That the number of issues offered in drives that are available for bank purchase after the drive closes be reduced. A substantial part of the speculation during the Fifth Drive arose from the fact that the basket included three issues available for bank purchase after the drive closed.

6. That the use of war loan deposits above a minimum uniform percentage be denied to all qualified depositaries who ignore the Treasury's request concerning speculative loans.

7. That consideration be given to a return to the practice of offering securities directly for commercial bank subscription. It is just as inflationary for banks to acquire securities indirectly as directly. If the indirect method serves to reduce bank purchases, it should be continued. If, however, it does not so serve, it would be preferable again to offer securities directly for commercial bank subscription. Banks might be permitted, as after the Third Drive, to purchase a limited amount of securities shortly after the close of the drive, when their excess reserves are large. Such purchases should serve to reduce the amount of speculative subscriptions from nonbank customers, since the secondary demand would be reduced. The corporate but not the individual quota should be reduced by the amount of the offering for direct bank subscription.

8. That trading in the marketable issues included in the drive be postponed until 15 days after the close of the drive.

9. That the Treasury make no increase in outstanding bills during the drive. Increases in outstanding bills are taken by the Federal Reserve, thereby adding to excess reserves, and consequently stimulate bank purchases.

August 11, 1944

TREASURY DEPARTMENT
OFFICE OF THE SECRETARY
WASHINGTON 25

August 14, 1944.

Dear Mr. Eccles:

Your letter of August 11, which forwarded a copy of the memorandum from the Executive Committee of the Federal Open Market Committee to the Secretary, has been received during Mr. Morgenthau's absence. Your letter and its enclosure will be brought to Mr. Morgenthau's attention when he is again at his desk.

Sincerely yours,

H. S. Klotz

H. S. Klotz,
Private Secretary.

Mr. M. S. Eccles,
Chairman, Board of Governors of the
Federal Reserve System,
Washington, D. C.