A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in Washington on Tuesday, February 20, 1940, at 10:15 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Davis
Mr. Draper

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
(latter part of meeting)
Mr. Thurston, Special Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Peulger, Chief of the Division of Examinations
Mr. Goldenweiser, Director of the Division of Research and Statistics
Mr. Cagle, Assistant Chief of the Division of Examinations
Mr. Van Fassen, Assistant Chief of the Division of Bank Operations

Messrs. Thomas M. Steele, Leon Fraser, Howard A. Loeb, B. G. Huntington, Robert M. Hanes, Ryburn G. Clay, Edward E. Brown, John Evans, R. E. Harding and Paul S. Dick, Members of the Federal Advisory Council representing the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Tenth, Eleventh and Twelfth Federal Reserve Districts, respectively

Mr. Shirley S. Ford, President of the Northwestern National Bank and Trust Company of Minneapolis, Minnesota, as alternate for Mr. John Crosby, representing the Ninth Federal Reserve District

Mr. Walter Lichtenstein, Secretary of the Federal Advisory Council

Mr. Ransom stated that following the meeting on Monday, February
19, the members of the Board had conferred and decided to furnish to each member of the Council a set of the four volumes containing studies written by members of the staff for consideration of the Board in connection with the preparation for presenting evidence in any hearings that might be held under the Wagner Resolution. He stated that these studies might be found useful if published in the Federal Reserve Bulletin or elsewhere. Mr. Ransom stated that a copy of the Table of Contents of these volumes was before each member of the Council and that this would give them an idea as to the subjects covered in these studies. He explained that the members of the staff had been requested to prepare these statements and had been told that they should be factual and should present information which would be helpful in considering the problems raised in the Board’s Annual Report for the year 1938 and that the Board would appreciate the comments and suggestions of the members and secretary of the Federal Advisory Council. He further stated that these studies would be distributed with the understanding that they were confidential and not for release or publication, as they had not as yet been passed upon in any way by the Board. He further reviewed briefly the circumstances under which the studies were prepared and said that the Board felt that it would be helpful if it could have the opinion of the members of the Council with such suggestions as they cared to offer as to additions to or omissions from these studies or any other suggestions which they felt would make them more useful.
Mr. Brown then stated that at its separate meeting the Council had again discussed the Mead Bill which would provide for the establishment of an industrial loan corporation to assist financial institutions in making credit available to commercial and industrial enterprises, and that although the Council had adopted no formal resolution on the matter it was still strongly of the opinion that there was no need for such loans by any Government agency as proposed in the various drafts of the bill. He added, in response to an inquiry that had been made by Mr. Draper, that if legislation on the subject was going to be passed the Council felt that no new Government agency should be created but that any additional authority should be lodged with an existing agency, preferably the Reconstruction Finance Corporation, for the reason that the Federal Reserve System, which is charged with the responsibility of handling bank reserves, should not be called upon to go into the field of direct lending to business ventures that are too hazardous to get funds through the ordinary channels. On the question of the repeal of the existing authority of the Federal Reserve System to make industrial loans, Mr. Brown said that the Council had not discussed this point but that he believed most of the members of the Council were of the opinion that the authority should be repealed for the reason that it is not being used to any considerable extent at the present time and the Reconstruction Finance Corporation has broader authority in the same field.

Mr. Brown also referred to the practice which was begun by
banks some four or five years ago of making term loans as the means of breaking down the deadlock which resulted largely from the requirements of the law and the Securities and Exchange Commission for the flotation of securities and said that the members of the Council felt that this practice had expanded on a large scale until nearly all banks with resources of as much as $50,000,000 or more were making such loans for longer terms than ever before and to a much lower grade of credit risk than was contemplated when the practice was first started.

During the discussion of various matters relating to industrial and term loans, reference was made to the published information with respect to new loans being made by banks and the opinion was expressed by some of the members of the Council that it was difficult to define the term "new loans" in such a way as would result in the submission of accurate information as to the number of new loans made. Mr. Hanes said that the American Bankers Association was undertaking at the present time another survey for the last six months of 1939 and hoped to have the resulting information available by the middle of March or the first of April.

Mr. Brown made the further statement that the Council, in response to an inquiry by Mr. McKee, had come to the conclusion that there was no likelihood of increased demand for bank credit or long term credit in the form of security issues or equity capital by industrial and commercial concerns, and that any demand from any business
that could show a reasonable expectation of profit could be met by
the banks without creating any strain that might cause the banks to
liquidate Government securities or other obligations. He made the ad-
ditional statement that the Council was of the opinion that if the
banks could be given the function of secondary underwriters it would
make it much easier for them to accommodate any demand that might
arise for long term bond financing.

With respect to a second question which had been asked by
Mr. McKee, Mr. Brown said the Council had no information with respect
to the extent to which a substantial decline in bond prices would ef-
fect the capital of banks, that on the basis of what the members of
the Council knew of the situation they thought a large majority of
banks were not in a position where their capital would be seriously
affected by as much as a ten point decline in the price of Government
securities, but that there was a certain minority of banks the capi-
tal of which would be wiped out by a ten point decline, and the
Council felt that such a situation might produce a condition which
would threaten the whole private banking system. For that reason,
Mr. Brown said, the Council was of the opinion that if the Board or
some statistical agency could make a study of the reports which were
submitted in response to the September 1939 call which was as of a
date within ten days of the low point in the Government securities
market, and determine what the effect of the market decline was on
the capital structure of banks it would be a very valuable thing to
do. Chairman Eccles stated that such a study had not been made.
At this point Mr. Clayton joined the meeting.

Following comments by Chairman Eccles on the possible future trend of interest rates and the policy of the Treasury of issuing long term Treasury obligations, he suggested that the problem of excess reserves of member banks and related questions were matters of fundamental concern to the System, and the Council could be helpful by assisting to formulate legislation that would deal with these fundamental questions.

Mr. Brown stated that the Council had given consideration to a question which had been raised by Chairman Eccles with respect to the present policy of the Government relating to the issuance of baby bonds and was unanimously of the opinion that a wide distribution among the general public of Government securities in relatively small amounts was very much to be preferred to having most of the public debt held by banks, insurance companies, and large trusts, that the advantage of such a wide distribution was sufficiently great to justify a higher rate of interest on baby bonds and other similar instruments than could be obtained in the open market, that the Government was justified in going to a considerable amount of expense in getting such a distribution, that the question whether the present differential between the rate on baby bonds and other obligations and the cost of distribution of the former is excessive is primarily a question for decision by the Treasury, but that some differential was entirely justified.
On the question of restricting the amount of baby bonds that might be bought by a single purchaser, Mr. Brown stated that the Council felt that that was relatively unimportant as long as banks, mutual savings banks and building and loan associations have large amounts of funds available for investment and that it was not felt that the fact that baby bonds could be cashed on demand at a decreased interest rate would threaten any sudden large demands on the Treasury although it might be that the loss of interest resulting from cashing the bonds before maturity should be increased.

Chairman Eccles said he expected the demand for baby bonds on the present basis to reach the rate of $1,000,000,000 a year, that it was estimated that 80% of the demand was from corporations and well-to-do individuals, and that the suggestion had been made that if the total amount of bonds which could be held by one purchaser were limited to $12,000 it would reduce the demand by 80% and would still result in the wide distribution to the general public that was being obtained at the present time. The reason for this, he said, was that at least 95% of the public would not be in a position individually to purchase more than a total of $12,000 of baby bonds. He added that if as much as $1,000,000,000 of such bonds were issued each year it was possible that all of the new funds required by the Treasury would be made available from that source rather than from the regular market and the question was whether the Government would be justified in paying the present large rate on baby bonds when it could get its funds in
the market at a much lower rate.

Mr. Brown stated that the Council felt that a wide distribution of the public debt among people of moderate means was highly desirable, and that in order to get that distribution it was proper to pay a higher rate and incur greater expense for distribution, but that, if the present system created too much of a differential and the object of wide distribution was being defeated by the fact that persons could purchase up to say $100,000 of baby bonds, the Council would not object to a change in the procedure. He added that the Council was glad to see that the Chairman did not want to limit the wide distribution by reducing the rate but rather by limiting the amount that might be acquired by one purchaser.

Mr. Lichtenstein read the following recommendation which had been adopted by the Council at its separate meeting:

"The Federal Advisory Council has noted that the Senate Committee on Banking and Currency is considering at this time S. 785 which would discontinue the purchase of foreign silver by the Secretary of the Treasury. The Council is unanimously of the opinion that these purchases of foreign silver should be discontinued forthwith, particularly in view of the fact that silver purchases increase the already excessively large bank reserves."

In explanation of the recommendation Mr. Brown said that the Council would favor the discontinuance of all silver purchases and although it realized that the present was not an appropriate time to advance that suggestion it was felt that the recommendation contained in the above resolution might be accepted. It was also made clear
during the ensuing discussion that the resolution related to purchases of foreign silver by the Treasury and not to such purchases by private individuals.

Mr. Brown said that the Council desired to request that the Board send the resolution to the Chairman of the Senate Banking and Currency Committee for its use in considering Bill S. 785 and that the resolution also be released to the press. The members of the Board indicated that they would have no objection to releasing the statement and it was understood that it would be sent today by messenger, with a letter of transmittal signed by the Secretary of the Board, to the Chairman of the Senate Committee on Banking and Currency and that Mr. Thurston would prepare a statement for the press which would be released upon approval by Mr. Brown.

Mr. Brown then stated that the Council had also considered a second point which had been raised by Chairman Eccles with respect to the future gold situation and that although the Council did not have any opinion as to the desirability of immediate action it desired to get the views of the members of the Board on the subject. He added that it was the general consensus of the Council that, if gold coin were put into circulation at the present price, that action of itself would have no material effect on the problem of excess reserves but would have what might be termed an advantage in that it would make it more difficult for the Government to further devalue the dollar and
that additional check on the possibility of further deflation might encourage the investment of capital to a greater extent than at the present time.

There followed a general discussion of the gold situation, after which the meeting adjourned.

Approved:

Chaiman.