A meeting of the Board of Governors with the Presidents of the Federal Reserve Banks and representatives of the Federal Advisory Council was held in Washington on Tuesday, December 17, 1940, at 2:10 p.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
Mr. Thurston, Special Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Director of the Division of Research and Statistics
Mr. Smead, Chief of the Division of Bank Operations
Mr. Dreibelbis, Assistant General Counsel

Messrs. Young, Harrison, Sinclair, Fleming, Leach, Parker, Schaller, Martin, Peyton, Hamilton, Gilbert, and Day, Presidents of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco, respectively

Mr. Edward E. Brown, President of the Federal Advisory Council

Messrs. Leon Fraser and Howard A. Loeb, Members of the Federal Advisory Council

Mr. Walter Lichtenstein, Secretary of the Federal Advisory Council

Messrs. John H. Williams and Robert G. Rouse, Vice Presidents, and Mr. H. H. Kimball, Assistant Vice President, of the Federal Reserve Bank of New York

Chairman Eccles referred to the appointment of committees by the Board of Governors and the Federal Advisory Council to confer for the purpose of ascertaining whether a statement could be prepared which could be agreed upon by the Council and the Board and which would discuss the monetary and credit problems which had been created by events leading up to the present situation and suggest the action that might be taken to meet these problems. He stated that in the discussion of the suggested statement it was felt by the two committees that the matter was of such importance that it would be desirable to bring the Presidents of the Federal Reserve Banks into its consideration, and that, if a statement could be prepared which would be acceptable, it could be sent to Congress as representing the view of all three groups. He made the further statement that as a practical way of approaching the matter he had requested Presidents Harrison and Sinclair to meet with the committees appointed by the Federal Advisory Council and the Board, that a meeting was held yesterday afternoon and again this morning, and that tentative agreement had been reached upon a preliminary draft of statement, copies of which had been furnished during this meeting to the members of the Board, the Presidents of the Federal Reserve Banks, and the members of the Federal Advisory Council who were present. He added that it was hoped that, if a statement could be agreed upon, it would be sent to Congress as soon as possible after the first of the year and possibly before that time, after having first been presented to the Secretary of the Treasury. The statement was not prepared, Chairman Eccles said, with the idea that it would be approved in final form by those present at this meeting, but that, if the substance of the statement were agreed upon, it could be placed in final form by a smaller committee appointed for the purpose.

The draft of statement was then read by Mr. Morrill.

Mr. McKee inquired whether all of the members of the Board, the Federal Advisory Council, and the Presidents who participated in the preparation of the draft of statement were in agreement with the draft and Chairman Eccles replied that there had been unanimous agreement on the substance of the statement but that it was understood that there might have to be further changes as to form.

Mr. Ransom said that the persons participating in the preparation of the memorandum had not seen the present draft which had been prepared as the result of suggestions made at the meeting of the representatives of the three groups this morning.

Chairman Eccles then inquired whether there was any disagreement among those who participated in the preparation of the statement with respect to its substance. No disagreement was expressed but Mr. Brown stated that it would be necessary to make further changes in detail.

Chairman Eccles asked for suggestions as to how the meeting might proceed with the consideration of the statement. In the discussion that followed question was raised whether the Board's committee had power to act for the Board in the final approval of the statement and Chairman Eccles replied in the negative.

Mr. Brown stated that the Federal Advisory Council's committee was authorized to act for the Council and that it could be assumed that the twelve members of the Council would approve the substance of the statement.

Chairman Eccles suggested that the Presidents and the Board meet in separate sessions to consider the draft of statement, and, if it were approved in substance, that each group could appoint a committee with authority to confer with the Federal Advisory Council committee and to approve the statement in a form which would be agreed upon by the three committees.

> This suggestion was agreed to unanimously with the understanding that the Board, the Presidents, and the representatives of the Federal Advisory Council would meet in separate sessions and that this meeting would reconvene at 4:00 p.m., or earlier if possible.

Thereupon the members of the Board and its staff withdrew to the Conference room. The representatives of the Federal Advisory Council met in Chairman Eccles' office and the Presidents remained in the Board room.

In the separate meeting of the Board, Chairman Eccles stated that the suggestion had been made that it might be desirable to undertake to obtain the approval of the proposed statement by the boards of directors of the Federal Reserve Banks, but that he was of the opinion that this would be inadvisable for the reason that it would result in substantial delay as it would have to be considered by a total of 108 directors, and that it would be difficult to preserve its confidential nature until it was ready for submission to Congress. The other members of the Board concurred in this opinion. Chairman Eccles added that it was proposed that, if the Presidents were not willing to join in a statement, and a statement could be agreed upon by the Board and the representatives of the Federal Advisory Council, it would be sent to Congress as representing the views of the Board and the Council.

The draft of statement was then discussed and certain minor changes agreed upon as shown on a copy of the statement which has been placed in the Board's files.

Mr. Goldenweiser inquired whether the Board was prepared to recommend that the power to change reserve requirements be placed in the Federal Open Market Committee. Chairman Eccles responded that there were two reasons for the recommendation, the first of which was that it was felt that only by requesting authority in this form could substantial opposition from commercial banks be avoided.

At this point President Harrison entered the room and said that the Presidents had voted unanimously to approve the substance of the report and had appointed Messrs. Harrison and Sinclair to confer with representatives of the Board and the Federal Advisory Council and to make such changes in the form of the proposed statement as might be agreed upon by the representatives of the three groups. He added that President Young had suggested the adoption of a resolution to the effect that the statement constituted a reversal of the present monetary policy of the System, but that he (President Harrison) had suggested that while it would not be possible to adopt such a resolution, the approval of the proposed statement would imply approval of a change from the condition of extreme monetary ease that now exists.

Mr. Harrison also said that the representatives of the Federal Advisory Council had just advised him that it appeared from information furnished to them by Mr. Smead that, if the Federal Open Market Committee were granted authority to increase reserve requirements as proposed in the draft of statement and all of that authority were exercised, there would be a total deficiency in required reserves of member banks of approximately $2,500,000,000 and that the representatives of the Council felt that such a proposal might unduly alarm the commercial banks.

Chairman Eccles pointed out that it would take some time to enact the proposed legislation, during which time there undoubtedly would be further substantial gold imports, and that the proposal contemplated that any change would not necessarily have to apply to all banks alike but that the Federal Open Market Committee would have authority to change reserve requirements for central reserve city banks, reserve city banks, country banks, or any combination of the three groups.

Mr. Harrison stated that he said to the representatives of the Council that it was inconceivable that the Federal Open Market Committee would take action to the maximum limit of its authority in the absence of substantial changes in the existing situation and that, while the representatives of the Council agreed with that statement, they questioned whether it would be possible to get Congress to grant the authority. The Council members, Mr. Harrison said, made no specific recommendation but suggested the possibility of a provision to the effect that the Federal Open Market Committee would not exercise the power to a point which would create deficiencies in member bank reserves or that the authority could be exercised only upon an affirmative vote of two thirds of the membership of the Committee. He added that such a change would be a change of substance and that if made it would be necessary for him to resubmit the matter to the Presidents for consideration.

Mr. Harrison then stated that he believed a majority of the Presidents would like to present the proposed statement to their boards of directors for approval and that they felt they could get immediate approval and would be willing to call special meetings of their respective boards for that purpose.

Chairman Eccles responded with the statement that the Board had discussed that point and felt that it would be a mistake to undertake to obtain the approval of the directors of the Federal Reserve Banks, particularly because of the difficulty that would be encountered in keeping the consideration of the matter confidential and because of the delay that inevitably would result.

Thereupon Mr. Harrison withdrew from the meeting.

Mr. Goldenweiser then raised for consideration the question whether it would be advisable to recommend that Congress increase the statutory reserve requirements to say three times the present percentages with a corresponding reduction in the proposed authority of the Federal Open Market Committee to increase requirements above the percentages fixed in the statute, it being understood, however, that the Committee would have authority if conditions required to reduce requirements below the stated statutory percentages. This possible change in the statement was discussed but it was agreed that it should not be proposed.

Mr. Ransom inquired as to the reason for requesting Congress to increase reserve requirements to twice the present statutory percentages when the Board already had authority to make such an increase, and it was pointed out that the proposed change in the statutory percentages would not only apply to member banks but to all banks receiving demand deposits regardless of whether or not they were members of the System.

Mr. McKee suggested, and the other members of the Board agreed with the suggestion, that in order to prevent information with respect to the proposed statement from becoming public it was essential that the statement be placed in final form and sent to Congress as promptly as possible.

> Thereupon Mr. Davis moved that the Board approve the substance of the statement and that Messrs. Eccles, Ransom, and Szymczak be authorized to meet with the committees appointed by the Presidents and the Federal Advisory Council and to approve such changes in the form of the statement as might be agreed upon by the three committees.
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> Mr. Davis' motion was put by the chair and carried unanimously.

At 3:50 p.m., the meeting of the Board, the Presidents, and the representatives of the Federal Advisory Council reconvened with the same attendance as at the earlier session.

Mr. Harrison stated that the Presidents had considered whether they should adopt a resolution to the effect that the approval of the statement would amount to a reversal of the present monetary policy of the System, that it was felt that it would not be appropriate to adopt such a resolution, and that the substance of the proposed statement had been approved unanimously. He also said that he and Mr. Sinclair had been appointed by the Presidents as a committee to meet with the committees appointed by the Board and the Federal Advisory Council to place the statement in final form.

Mr. Fraser said that the representatives of the Council were in agreement with the substance of the proposed statement but that there was one point of substance which it was felt was of considerable importance and which he would request Mr. Brown to discuss.

Mr. Brown made the statement that when consideration was given at the meeting yesterday to the proposed authority to the Federal Open Market Committee to make changes in reserve requirements no information was available as to the effect of the exercise of the proposed authority on excess reserves of banks, that Mr. Smead had presented information on this point to the representatives of the Council which indicated that if reserve requirements were increased to the maximum limits stated in the proposed memorandum there would be created a deficiency in member bank reserves of around $2,500,000,000 to which would have to be added an additional amount of between $700,000,000 or $800,000,000 representing estimated deficiencies in required reserves of nonmember banks. He said the representatives of the Council were not afraid to grant this additional authority to the Federal Open Market Committee but questioned whether it would be possible to get the support of the banks for such a proposal, and that while it was realized that there would be further substantial gold imports before the proposal was enacted into law, it was suggested that consideration be given to restricting the power of the Committee by a provision that no increase in reserve requirements would be made which would have the effect of creating a deficiency in bank reserves or a provision which would limit the power of the Open Market Committee to increase reserve requirements to, say, 80% of the proposed statutory percentages.

Discussion of the point raised by Mr. Brown led to a suggestion by him that the three committees be authorized to make such changes as they deem advisable in paragraph (b) of the proposed statement, which deals with the authority of the Federal Open Market Committee to change reserve requirements, with the understanding that any change would include a provision to the effect that the authority to increase reserve requirements could not be exercised beyond the point where excess reserves would be eliminated.

Chairman Eccles suggested that if the three committees were authorized to make such a change in the statement they should also be authorized to change the proposed statutory percentages.

Upon motion by Mr. Brown, it was agreed unanimously that the three committees should be given the authority suggested by him and Chairman Eccles.

Chairman Eccles stated that the Board had approved the substance of the report and had authorized its committee to meet with the committees of the Presidents and the Federal Advisory Council and place the statement in final form.

He then referred to the suggestion previously made with respect to the importance of sending the statement to Congress promptly and to the further suggestion that it be sent up immediately without waiting for the new Congress to convene after the first of the year. There appeared to be unanimous agreement with this suggestion and it was proposed that the three committees meet following this meeting for the purpose of placing the statement in final form, and of appointing a subcommittee to inform the Secretary of the Treasury of the action which had been taken, it being understood that after the statement had been presented to the Secretary it would be sent to Congress immediately.

Mr. Szymczak raised the question as to the procedure to be followed in the event the Secretary of the Treasury should request that the statement be not sent until he could have an opportunity to study it, or in the event he presented reasons why it should not be sent.

Chairman Eccles suggested that if the subcommittee should feel, after meeting with the Secretary, that there were reasons which appeared to make it inadvisable to submit the statement to Congress, the matter should be taken up again with the three committees. In this connection, Chairman Eccles referred to the Wagner questionnaire and to the fact that all of the points covered in the proposed statement would have to be referred to in the answers to the questionnaire, and said that it was his opinion that the fundamental questions involved could be presented to Congress in a more satisfactory form in the proposed statement than in the form of answers to the detailed questions in the Wagner questionnaire.

President Young again expressed the opinion that approval of the statement constituted a reversal of the present monetary policies of the System. It was the general consensus, however, that the proposed action would not constitute a reversal of policy but that the statement should be interpreted as meaning that while the System did not favor the situation of extreme monetary ease that exists at the present time, it also did not favor a policy of high money rates.

At the conclusion of this discussion, it was agreed unanimously that the three committees should meet and proceed as outlined above.

Thereupon the meeting adjourned.

Secretary's note: Following this meeting the committees of the Board, the Presidents, and the Federal Advisory Council met and agreed upon certain changes in the proposed statement. By unanimous vote, Messrs. Eccles, Brown, and Harrison were authorized to perfect the statement and to present it to the Secretary of the Treasury. This action was taken with the understanding (1) that the presentation of the statement to the Secretary of the Treasury was merely for the purpose of informing him of the action that had been taken by the Board, the Presidents, and the Federal Advisory Council, and (2) that if, as a result of the meeting with the Secretary, there was any reason which, in the opinion of the subcommittee, warranted a resubmission of the statement to the three committees, the committees would be requested to meet again. Thereafter the subcommittee reviewed the draft at meetings on December 17 and 18, and an appointment to see the Secretary at 9:15 a.m. on December 19 was arranged for the purpose of presenting the statement to him at that time.

The statement as finally agreed upon for submission to the Secretary of the Treasury read as follows:

"For the first time since the creation of the Federal Reserve System, the Board of Governors, the Presidents of the twelve Federal Reserve Banks, and the members of the Federal Advisory Council representing the twelve Federal Reserve Districts present a joint report to the Congress.

"This step is taken in order to draw attention to the need of proper preparedness in our monetary organization at a time when the country is engaged in a great defense program that requires the coordinated effort of the entire Nation. Defense is not exclusively a military undertaking, but involves economic and financial effectiveness as well. The volume of physical production is now greater than ever before and under the stimulus of the Defense program is certain to rise to still higher levels. Vast expenditures of the military program and their financing create additional problems in the monetary field which make it necessary to review our existing monetary machinery and to place ourselves in a position to take measures, when necessary, to forestall the development of inflationary tendencies attributable to defects in the machinery of credit control. These tendencies, if unchecked, would produce a rise of prices, would retard the national effort for defense and greatly increase its cost, and would aggravate the situation which may result when the needs of defense, now a stimulus, later "absorb less of our economic productivity. While inflation cannot be controlled by monetary measures alone, the present extraordinary situation demands that adequate means be provided to combat the dangers of overexpansion of bank credit due to monetary causes.

"The volume of demand deposits and currency is fifty per cent greater than in any other period in our history. Excess reserves are huge and are increasing. They provide a base for more than doubling the existing supply of bank credit. Since the early part of 1934 fourteen billion dollars of gold, the principal cause of excess reserves, has flowed into the country, and the stream of incoming gold is continuing. The necessarily large defense program of the Government will have still further expansive effects. Government securities have become the chief asset of the banking system, and purchases by banks have created additional deposits. Because of the excess reserves, interest rates have fallen to unprecedentedly low levels. Some of them are well below the reasonable requirements of an easy money policy, and are raising serious, long-term problems for the future well-being of our charitable and educational institutions, for the holders of insurance policies and savings bank accounts, and for the national economy as a whole.

"The Federal Reserve System finds itself in the position of being unable effectively to discharge all of its responsibilities. While the Congress has not deprived the System of responsibilities or of powers, but in fact has granted it new powers, nevertheless, due to extraordinary world conditions, its authority is now inadequate to cope with the present and potential excess reserve problem. The Federal Reserve System, therefore, submits for the consideration of the Congress the following five-point program:

"1. Congress should provide means for absorbing a large part of existing excess reserves, which amount to seven billion dollars, as well as such additions to these reserves as may occur. Specifically, it is recommended that Congress -

(a) Increase the statutory reserve requirements for demand deposits in banks in central reserve cities to 26%; for demand deposits in banks in reserve cities to 20%; for demand deposits in country banks to 14%; and for time deposits in all banks to 6%.

"(b) Empower the Federal Open Market Committee to make further increases of reserve requirements sufficient to absorb excess reserves, subject to the limitation that reserve requirements shall not be increased to more than double the respective percentages specified in paragraph (a).
(The power to change reserve requirements, now vested in the Board of Governors, and the control of open market operations, now vested in the Federal Open Market Committee, should be placed in the same body.)

(c) Authorize the Federal Open Market Committee to change reserve requirements for central reserve city banks, or for reserve city banks, or for country banks, or for any combination of these three classes.

(d) Make reserve requirements applicable to all banks receiving demand deposits regardless of whether or not they are members of the Federal Reserve System.

(e) Exempt reserves required under paragraphs (a), (b) and (d) from the assessments of the Federal Deposit Insurance Corporation.

"2. Various sources of potential increases in excess reserves should be removed. These include: the power to issue three billions of greenbacks; further monetization of foreign silver; the power to issue silver certificates against the seigniorage, now amounting to one and a half billion dollars on previous purchases of silver. In view of the completely changed international situation during the past year, the power further to devalue the dollar in terms of gold is no longer necessary or desirable and should be permitted to lapse. If it should be necessary to use the stabilization fund in any manner which would affect excess reserves of banks of this country, it would be advisable if it were done only after consultation with the Federal Open Market Committee whose responsibility it would be to fix reserve requirements.

"3. Without interfering with any assistance that this Government may wish to extend to friendly nations, means should be found to prevent further growth in excess reserves and in deposits arising from future gold acquisitions. Such acquisitions should be insulated from the credit system and, once insulated, it would be advisable if they were not restored to the credit system except after consultation with the Federal Open Market Committee.

"4. The financing of both the ordinary requirements of Government and the extraordinary needs of the defense program should be accomplished by drawing upon the existing large volume of deposits rather than by creating additional deposits through bank purchases of Government securities. We are in accord with the view that the general debt limit should be raised; that the special limitations on defense financing should be removed; and that the Treasury should be authorized to issue any type of securities (including fully taxable securities) which would be especially suitable for investors other than commercial banks. This is clearly desirable for monetary as well as fiscal reasons.

"5. As the national income increases a larger and larger portion of the defense expenses should be met by tax revenues rather than by borrowing. Whatever the point may be at which the budget should be balanced, there cannot be any question that whenever the country approaches a condition of full utilization of its economic capacity, with appropriate consideration of both employment and production, the budget should be balanced. This will be essential if monetary responsibility is to be discharged effectively.

"In making these five recommendations, the Federal Reserve System has addressed itself primarily to the monetary aspects of the situation. These monetary measures are necessary, but there are protective steps, equally or more important, that should be taken in other fields, such as prevention of industrial and labor bottlenecks, and pursuance of a tax policy appropriate to the defense program and to our monetary and fiscal needs.

"It is vital to the success of these measures that there be unity of policy and full coordination of action by the various Governmental bodies. A monetary system divided against itself cannot stand securely. In the period that lies ahead a secure monetary system is es-

"sential to the success of the defense program and constitutes an indispensable bulwark of the Nation."

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.