A meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks was held in Washington on Tuesday, February 3, 1942, at 10:00 a.m.

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

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Dreiblebis, Assistant General Counsel
Mr. Smead, Chief of the Division of Bank Operations

Messrs. Roy A. Young, Sproul, Williams, Fleming, Leach, McLarin, C. S. Young, Davis, Peyton, Leedy, 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.

Messrs. Bryan and Stroud, First Vice Presidents of the Federal Reserve Banks of Atlanta and Dallas, respectively, and Mr. Sienkiewicz, Secretary of the Presidents' Conference.

Mr. Day stated that the Presidents met in separate session yesterday and expected to finish the consideration of their program this afternoon, but that there were certain matters which they would like to have the Board discuss this morning. He then suggested that Chairman Eccles might inform the Presidents regarding the provision which had been included in the second war powers bill for the purpose of
eliminating from Section 14(b) of the Federal Reserve Act the prohibition against the purchase by the Federal Reserve Banks of direct and guaranteed obligations of the United States other than in the open market.

Chairman Eccles reviewed the history of the amendment and the discussions which members of the Board had had with members of Congress and others regarding it. He also said that it had not been taken up with the Presidents or the representative members of the Federal Open Market Committee before it was introduced in Congress because the whole war powers bill was an administration measure which was drafted in confidence and that there had been no opportunity to discuss it outside the Board. He added that the bill was referred to the Judiciary Committees of Congress rather than the Committees on Banking and Currency, and that the Board had had no voice in that reference. He added that if there were any fault in not taking it up with the Presidents or the representative members of the Federal Open Market Committee before it was introduced he would have to take the responsibility for that because of the confidential circumstances under which the bill was prepared.

Chairman Eccles then discussed the arguments that might be made against the amendment, why in his opinion they were not valid objections, and why the proposed change should be made. He said it was anticipated that the power to purchase directly from the Treasury, if
granted, would not be used unless a necessity therefor developed, and that it was hoped that need for the use of the power would arise only in exceptional circumstances as, for instance, in a situation where a Treasury issue temporarily could not be sold and the Treasury was in need of funds, in which case the Federal Reserve Banks would take the issue and re-sell it to the market either through the dealers or through the Federal Reserve Banks and their branches as the market was able to absorb it. He added that there was no hidden purpose or plan on the part of the Board or the Treasury in connection with the amendment, that the purchase of securities from the Treasury in the circumstances he had outlined was as far as the System was likely to go in the use of the authority granted by the amendment, and that it was felt that if the Treasury would adopt the suggestions offered by the Federal Open Market Committee with respect to a program of Treasury financing it might be possible to avoid any necessity for the use of the power in this manner.

During Chairman Eccles' statement, Mr. Thurston entered the room.

Mr. McKee expressed the opinion that it was not likely that the Treasury Department would be willing to give up the open market method of financing and that it was his thought that the authority which would be granted by the amendment would be used to furnish funds for a short period over tax dates or to meet a temporary emergency such as the purchase of a part of an issue of bills so that the issue would
2/3/42

not fail because of some unforeseen event such as Pearl Harbor. He also said that he was opposed to reducing reserve requirements if that could be avoided and he concurred in the comment made by Chairman Eccles that one of the principal reasons for the amendment was that it might avoid any necessity for such action.

Chairman Eccles stated that his suggestion that the Federal Reserve Banks might purchase Government securities and sell them to the market was merely a change in the method of distribution and did not get away from the principle of an open market, and that instead of having to undertake to price an issue at a figure which would attract heavy over-subscriptions the securities could be taken by the System and sold to the market as it could absorb them. He said he did not know how long the present method of financing could be continued and he questioned whether it might not be desirable to change the method of distribution and whether the Federal Reserve Banks were not an admirable agency through which to effect distribution in somewhat the same manner as is now followed in the distribution of defense bonds.

Mr. Goldenweiser joined the meeting during the course of Chairman Eccles' statement.

Mr. Ransom referred to comments by Messrs. Eccles and McKee that suggested the possibility of a feeling on their part that the Presidents might be opposed to the proposed amendment, and they both made it clear that they had not intended to convey that impression.
Mr. Ransom then discussed some of the background of the amendment to Section 14(b) which was made by the Banking Act of 1935 and which inserted the provision prohibiting the purchase of Government securities by the Federal Reserve Banks except in the open market. He expressed the opinion that the change regarding purchases in the open market made in the Banking Act of 1935 was not, in the light of his experience as a member of the Board for six years, an altogether advisable change and that the Federal Reserve System and the Federal Open Market Committee could be trusted to act in the public interest in open market operations, including the purchase of Government securities directly from the Treasury.

Following Mr. Ransom's statement, Mr. Day asked for any comments that the Presidents might have to make, and Mr. Sproul stated that he did not want to appear critical of the amendment because he favored it but that he felt there was a serious administrative defect in the organization of the Federal Reserve System if a matter of such importance to the Federal Open Market Committee could not be brought to the attention of the representative members of the Committee before a recommendation was made by the Board. He felt that there had been sufficient time between the consideration of the amendment as a possible part of the first war powers bill and its insertion in the second war powers bill to take it up with the representative members, and that there was an implication that the matter could not be taken up with them because they might undertake to work against it which he
did not believe would have been the case. He expressed the further opinion that, if the System purchased large amounts of securities from the Treasury, that method of operation might have an inflationary effect psychologically because it might cause the public to lose confidence, and that it was somewhat revolutionary to talk in terms of the Federal Reserve System acting as the distributing agent for Government securities. He concluded with the statement that the proposed change was being accepted by the dealers and others as a power which the System should have for the purpose of lending temporary assistance over tax periods and other periods of market stringency but that it was not being accepted on the basis of the System taking securities from the Government and disposing of them as they could be absorbed by the market.

Mr. Ransom stated that it would have been most desirable if the suggested amendment could have been thoroughly discussed, and that, if the Board had proposed a separate bill for the purpose, that would have been done, but that the only possibility seemed to be to make it a part of the war powers bill which was a confidential administrative measure in time of war. He added that there might not have been any objection to discussing it with the Presidents even in that situation but the members of the Board felt that they were not free to take that step. He added that he would regret very much any feeling on the part of the Presidents that the Board had failed to be as frank as it should be and as always had been its policy in the past.
Chairman Eccles said that conditions would not always be such as to make it possible to discuss contemplated legislation with the Federal Reserve Banks, that the position of the Board, and particularly his position as Chairman of the Board, was somewhat different from that of the Presidents, regardless of whether they were members of the Federal Open Market Committee, and that the Presidents, Chairmen, and Federal Advisory Council constituted a group too large and scattered to permit all proposed legislation to be discussed with them. He added that there might be times when desirable legislation might seem to be in conflict with their interests, and that at such times they could not be expected to propose or favor such legislation.

Mr. Szymczak said that he did not agree with Chairman Eccles' comment, that it had been the practice in the past to regard all parts of the System as one, that one of the most effective ways to do that was to exchange information whenever possible to act as a unit on any job to be done, and that this practice should be followed at the present time more than ever before. The amendment under discussion, he said, was a matter of direct interest to the representative members of the Federal Open Market Committee, which has an important responsibility for action in the public interest, and that, while all such matters should be taken up with them, it had not been possible to do so in this case because of the conditions under which it arose.

Chairman Eccles said he was not in disagreement with the position that it was desirable for the System to act as a unit, but he thought that there would be circumstances in which it might not be
possible to do it and that this position was not based on any lack of confidence in the Presidents. He felt it was a mistake for the central bank in any country to regard itself as being completely independent, that the kind of independence a central bank should have was an opportunity to express its views in connection with the determination of policy, and that after it had been heard it should not try to make its will prevail but should cooperate in carrying out the program agreed upon by the Government. Any attempt, he said, on the Part of the Federal Reserve System to maintain any other kind of independence would be an impractical position which would result in the loss of authority and influence that it otherwise might have.

Mr. Ransom suggested that in the present conditions of war and revolutionary change it was more important than ever that the different parts of the System cooperate as fully as possible in discharging its responsibilities.

Mr. Williams expressed appreciation of the frank statements by the members of the Board and suggested that if any further discussion was believed to be necessary it be carried on by a committee of the Presidents meeting with a member or members of the Board.

Mr. Ransom stated that if the Presidents had any further comments to make on the matter the Board would like to receive them.

Mr. Day said that in their separate meeting the Presidents had discussed Regulation W, Consumer Credit, and the industrial loan
operations of the Federal Reserve Banks under Section 13(b) of the Federal Reserve Act and that they would like to have any comments that the Board might wish to make on these subjects.

Chairman Eccles referred briefly to the history of the various drafts of the so-called Mead Bill providing for loans to small business concerns, to the development of the defense contract service and its successor, the contract distribution service, and to the present desire of the War and Navy Departments and the War Production Board for an arrangement which would make practicable the prompt financing of additional facilities, or the conversion of existing facilities, of small contractors for war purposes. He felt that in this situation the Federal Reserve System was in a much better position than any other organization to furnish the medium through which such financing could be decentralized and handled expeditiously. He said that the Mead Bill was not adequate to meet the situation and that therefore a draft of bill (a copy of which has been placed in the Board's files) had been prepared. He read the preamble to the bill and, after outlining the principal provisions of the proposed legislation, reviewed the discussions which he had had with several interested representatives of Government regarding it. He concluded his comments with the request that the whole matter be kept confidential for the time being and with a statement that it would be helpful when the bill was introduced if the Presidents would be willing to give such support to it in
During Chairman Eccles' statement, Mr. Draper left the meeting to keep an important appointment, and at the conclusion of the statement Mr. Parry, Chief of the Division of Security Loans, came into the room.

Mr. Ransom said that undoubtedly the Presidents would like to know what the Board has in mind as to the future of Regulation W. As difficult problems to deal with in connection with the regulation, he referred to the feeling on the part of banks and others that they would prefer any other kind of control than the control of credit and the further dislocation that is apt to result in sales organizations if Regulation W is tightened. He emphasized the fact that the regulation was of relatively minor importance in the list of instruments available to the Government with which to fight inflation but that the Office of Price Administration and the War Production Board were asking the System for such help as the regulation could give as a supplement to the instruments of priorities, rationing, and price controls which at best worked only imperfectly. He said that in the past the System had always acted on what it regarded as reasonably satisfactory statistical data, but that in the field of consumer credit control there were as yet no adequate sources of information, and that, therefore, the System was faced with the necessity of acting on the basis of incomplete data or of turning the job over to the Office of Price
Administration which would have to take action on the same basis.

He then discussed the problems that were being faced in connection with watches, bicycles, and used cars, and the problem whether the same terms should be applied in the regulation to wool floor coverings as were applied to furniture, and he outlined the manner in which the regulation might be of assistance in supplementing the actions of the Office of Price Administration in these fields.

He stated that there were two ways in which the formulation of Regulation W might have been approached, one of which was to include only a few articles at the beginning and gradually to include additional articles and to tighten the terms of the regulation, with the attendant possibilities of increasing annoyance on the part of those affected. The other was to do as Canada had done, that is, to take sweeping action at the outset by including a broad list of articles and applying strict terms, and subsequently modify them gradually on the basis of experience, which might result in feelings of relief and gratitude. He was inclined to believe that, while the latter plan had definite disadvantages, it might have been the more practical procedure to follow in the long run.

As his personal view with respect to the future of Regulation W, Mr. Ransom expressed the opinion that every available instrument eventually would be used to cause manufacturers to produce the things that would be required for the war effort and that to that end Regulation W might well be used for purposes which were not thought of
when it was adopted last September.

At the conclusion of Mr. Ransom's statement, it was understood that he, Mr. Szymczak, and Mr. Parry would meet with the Presidents again this afternoon for a further discussion of Regulation W.

Mr. Sproul stated that comments with respect to the draft of industrial loan bill referred to by Chairman Eccles indicated some difference of opinion on the part of members of the Board with respect to the bill and he inquired whether that was so.

Mr. McKee said that there was a definite question in his mind whether it would be possible as a practical matter for the corporation provided in the draft of bill to delegate its authority to pass upon individual transactions to the extent contemplated, that in his opinion such a delegation would not be possible, and that the responsibility for action would have to remain with the corporation at Washington.

Chairman Eccles stated that he would like to know whether the Presidents and the Board felt that the matter should be dropped, that he felt it would be inadvisable to do so, and that if that were the final conclusion an important activity in the credit field would be allowed to go elsewhere.

Mr. Ransom said that he thought there might be some better way to finance the war activities of small contractors than by creating an industrial loan corporation. He also questioned the desirability of referring in the draft of bill to essential civilian production for
the reason that if the war effort continued to move as rapidly as at present there would be very few items that would be included in that category, and he stated that the draft of bill would take on a different light if it were limited to production for war purposes.

Mr. Day then called upon Mr. McKee for his comments with respect to a suggestion that he had made that the Federal Reserve Act be amended to repeal the prohibition against member banks paying dividends or making loans while their reserves are deficient, it being understood that that power would be left in the Board of Governors to prescribe penalties for deficiencies in reserves. The essential points of the statement made by Mr. McKee in response to this request were in a memorandum which he had prepared before this meeting. At the request of Mr. Day, copies of the memorandum were made and furnished to the Presidents for their consideration and a copy has been placed in the Board's files.

Discussion of Mr. McKee's suggestion ensued, during which he stated that he felt very strongly that the amendment should be made as a means of helping to reduce the possibility of situations arising in which the System might find it necessary to purchase Government securities or to reduce reserve requirements and to lighten the pressure on member banks to withdraw from membership in the Federal Reserve System.
At the conclusion of the discussion, the meeting adjourned.

Cohester 
Secretary.

Approved:

Chairman.