A meeting of the Board of Governors of the Federal Reserve System with the Executive Committee of the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Thursday, March 12, 1942, at 10:35 a.m.

PRESENT: Mr. Ransom, Vice Chairman
Mr. McKee (part of meeting)
Mr. Draper (part of meeting)

Mr. Bethea, Assistant Secretary
Mr. Clayton, Assistant to the Chairman

Messrs. Edward E. Brown, William F. Kurtz, R. V. Fleming, and S. E. Ragland, members of the Executive Committee of the Federal Advisory Council

Mr. Walter Lichtenstein, Secretary, Federal Advisory Council

Mr. Ransom stated that, inasmuch as this is the first meeting to be held with the Council's Executive Committee in accordance with the schedule agreed upon following the last meeting of the Board with the Federal Advisory Council, he regretted that it was not possible for all members of the Board to be present. He explained that Messrs. Eccles, Draper and McKee were serving on the Executive Committee of the Federal Open Market Committee and that it was necessary for them to meet this morning on open market matters prior to conferring this afternoon with the Secretary of the Treasury on government financing. He said that Chairman Eccles was therefore unable to be present and that Messrs. McKee and Draper were in a position to meet with the members of the Council for only a short time prior to going to the other meeting. Mr. Ransom also explained that Mr. Szymczak was on the Pacific coast on official business of the Board and that Mr. Evans had not yet entered upon his duties as a member of the Board.

Mr. Brown stated that the topics which his Committee would like to discuss with the Board were (1) the questions which Mr. Ransom had previously discussed over the telephone with him and other members of the Council relating to Regulation W, namely, (a) whether open book or charge accounts should be regulated, (b) what if any regulation should be imposed on ordinary term loans for the purpose of purchasing, or making down payments on, listed articles, and (c) whether all non-purpose loans could be excluded from the regulation; and (2) the progress made by the Board in conferences with the Treasury looking toward the formulation of a long range program for financing the war.

Mr. Ransom suggested that in view of the fact that Messrs. McKee and Draper would have to leave the meeting shortly, it might be preferable to discuss the second topic first.

Mr. McKee stated that progress made in the discussions with the Treasury since the last meeting of the Council had been encouraging and that he was hopeful that some agreement might be reached on the Board's proposal which had been discussed in a general way during the last meeting with the Council. He expressed the view that it would be necessary to make some adjustments with respect to the reserve situation in the money market and stated that there was a question whether future market issues of the Treasury would suffer because of the lack of liquidity in the New York market. He asked the members of the Council what in their opinion could be done to put more money in the "street" without reducing reserve requirements.

Mr. Fleming said that of course banks outside of New York City could keep more funds on deposit with their New York correspondents and ease the situation in that way. Mr. Brown, however, said that he saw no more reason why correspondent balances should be kept in New York than in Chicago, St. Louis or other Reserve Bank cities. He went on to say that the present procedure followed by the Treasury whereby it operates on a twenty-four hour basis is likely to break down unless some program for financing the war is agreed upon and made public. He said that insurance companies as well as banks feel that they should be given some indication of the Treasury's long range policy.

Mr. Kurtz suggested that the Treasury and the Federal Reserve System should get away from the "New York complex" and recognize the changes which are taking place. He said that the gold inflow from which New York had benefited had practically ceased and that money invested in New York will in future be spent elsewhere to an even greater degree.

Mr. Brown stated that foreign trade had almost disappeared with the war and that the stock market was quite inactive. He also felt that too much emphasis was being placed on New York as the money market and that its importance from that standpoint will continue to diminish. In fact, he said, the Treasury has only a few months left in which to make preparations for changing its methods of financing if it is to avoid a collapse of the existing marketing machinery.

Mr. McKee indicated that deposits in New York City banks during 1941 had remained almost stationary whereas the deposits in banks in Chicago and some of the other Federal Reserve Bank cities had increased substantially. In this connection Mr. Fleming pointed out that with the flow of money to interior banks having smaller capital ratios than those in New York City there is less elasticity in the event it becomes necessary to use those deposits.

Mr. Brown said that money and securities are being withdrawn from New York City banks partly because of the fear of air bombardment.

Mr. Kurtz stated that Treasury sales of defense savings bonds also had the effect of withdrawing money from New York City banks. He added that in his opinion it might be more dangerous than helpful to carry larger correspondent balances with New York institutions in view of present trends.

Mr. Ransom said that he thought representatives of the Board had about reached an agreement with representatives of the Treasury that the Treasury should have a "pattern of rates" but that he recognized the difficulty of translating this into a precise definition of just what such a pattern should be. He said that he felt it was important first to agree on the general principles involved and that thereafter the details could be worked out in agreement between those responsible for carrying out the policy. He said that, in his judgment, it was not feasible for the Treasury now to fix the rates on all future issues but he thought it would be helpful if the Treasury could reach a decision that it was not going to pay more than 2-1/2 per cent for long-term money during the war and that something in the way of a public understanding of this decision would be helpful, that deciding upon 2-1/2 per cent as a rate for the purpose would establish a "bench mark" and when the maximum maturity had been decided, all other rates could be kept in line in accordance with the investment characteristics and maturities of other market issues. He said that when such a decision was reached and there was an agreement upon a pattern of rates for the future, the Federal Reserve System would of course adapt its operations to such a program and this would enable it to support the Treasury's program more effectively than otherwise might be the case.

Mr. Draper referred to the discussion at the last meeting with the Council of the proposed amendment to section 7(d) of the Securities and Exchange Act of 1934 and stated that following receipt of a copy of Mr. Brown's letter of March 2, 1942, to Congressman Lea, as Chairman of the Committee on Interstate and Foreign Commerce, he had requested members of the staff in the Board's Division of Security Loans to review the points made in the letter and prepare a memorandum containing such comments as seemed appropriate. He said that it had been his thought that the substance of the memorandum might be called to the attention of the members of the Council's Executive Committee at this meeting. However, at Mr. Ransom's suggestion, it was agreed unanimously that copies of the memorandum should be mailed to each member of the Committee for his information.

Mr. Brown said that if a member of the Board would indicate to the subcommittee having charge of this legislation that the proposal should be dropped he thought that would be the most effective thing that could be done. Mr. Ransom explained that this could not properly be done without a reconsideration of the matter by the Board. He said that the proposal originally had been approved by certain members of the Board, including himself, and that he had thought at the time that the proposal was in the public interest but felt sure that any arguments against the proposal, if brought to the attention of the Board, would cause the proposal to be reconsidered. He also said that he did not understand that the proposed legislation was likely to be enacted by the present Congress but that he might be mistaken on this. He suggested, in light of developments, that the Board might want to reconsider the recommendation it had previously made.

Messrs. McKee and Draper were called from the meeting at this point.

Mr. Ransom referred to the earlier discussion regarding the money market, saying that he thought the members of the Council should give consideration to the fact that the traditional conception of central banking was inevitably related to "a money market" but that possibly changing conditions might in the course of time substitute some other city for New York as "the money market". He also referred to the fact that there might be inherent in the original conception of the Federal Reserve System the idea that there might be in this country twelve money markets. He thought that the relation of this problem to the operations of the Federal Reserve System as our agency of central banking could not be overlooked and merited continuing consideration by all interested in the System and its role in the national economy. He inquired of the members of the Council, in view of the opinion expressed by some of them this morning that New York, as a money market, is becoming less important, what they would suggest as a substitute, asking whether they thought that a number of money markets might take over the role heretofore performed by New York and whether they thought that some one city, say Chicago, might be the successor to New York if they were right in their opinion that New York was destined to lose its position as the money market of the country. He said that in his opinion it might be impossible to legislate a group of money markets into existence or to substitute one city for another in the performance of the role of the money market. He reminded them of the discussion that had taken place on several occasions that all 12 of the Federal Reserve Banks might be put on an equal basis, so far as keeping them constantly advised of bids or offers on Government securities in whatever city that was functioning as the recognized money market, that the perfection of telegraphic communication did make it possible to have each of the 12 Federal Reserve Banks maintain a record of immediate changes in the Government bond market, permitting these banks in turn to inform anyone in their district interested in the matter of such changes, and that this might have some advantage in further expanding the usefulness of the System in relation to its obligations in connection with the Government bond market.

Mr. Brown again stated that he could not see why there should be only one money market when through the use of telephone and telegraph transactions can be handled expeditiously at other points. He said that the situation would be even more favorable to banks in Chicago and other Federal Reserve Bank cities if the Treasury would authorize the Reserve Banks to transfer all government securities by telegraph as is presently done in the case of Treasury bills. He also said that he recognized that it had been the classical view that there should be only one money market but that between 1900 and 1910, for example, Chicago was quite independent of New York City. He also referred to the fact that at one time Germany, Belgium and certain other European countries had several money markets.

Mr. Ransom referred to the questions concerning Regulation W which he had discussed over the telephone during the last ten days with certain members of the Council and stated that he and members of the Board's staff had recently had numerous conferences with representatives of the trade and members of the staff of the Office of Price Administration but that the Board desired all the information which it could obtain on the subject.

Mr. Brown said that, as he understood the questions, it appeared that the Board was committed to the general theory that it wished to regulate the purchase of listed articles but it seemed to him that this purpose was being accomplished through priorities and rationing. He stated that in his opinion furniture did not conflict in any way with the war effort and that he would like to see it eliminated from the "listed articles". With respect to the proposal to regulate charge accounts, he said there are many people whose income is seasonal and that the proposed action would cause great dislocation in the buying habits of people according to the areas in which they lived. He also said that department stores, such as Marshall Field's in Chicago, sell nothing on the instalment plan, whereas many department stores sell from 90 to 95 per cent of their merchandise on an instalment basis. Department stores, generally, he said, show large increases in sales and so far as he could see there had not been any dampening effect on demand by reason of the existence of Regulation W. Mr. Brown went on to say that merchants like to get good charge accounts because in this way they get good customers and that he thought that it would be undesirable to disturb existing merchandising practices merely for the purpose of preventing evasions to Regulation W. He said that, although it is true that there are considerable stocks of certain products on hand, the government is regulating the disposition of the more important ones by direct methods as for example refrigerators and ice boxes. He also said that in his opinion the Office of Price Administration has overemphasized the importance of tightening Regulation W because the restrictions on typical charge accounts at good stores are greater than those which would be imposed under Regulation W. In Chicago, he said, savings accounts are off about 4.2 per cent but department store sales, exclusive of furniture sales which had not gone up with the general swing, are up from 38 per cent to 50 per cent. Shortage of wool and other commodities, he stated, stimulates buying for cash. Mr. Brown concluded by indicating that he was opposed to broadening Regulation W at this time, thus necessitating the setting up of additional machinery and creating a great deal of antagonism toward the Federal Reserve System.

Mr. Fleming stated that merchants have developed a practice of keeping customers in debt. He said that recently he had been informed on good authority that one effect of the regulation of consumer credit in Canada had been to encourage people to buy a year's supply at one time on open book account and then to take a year in which to pay. He felt that the inclusion of charge accounts under Regulation

W might encourage twelve month open book credit in this country. He said that in his judgment the Office of Price Administration should discontinue the practice of announcing in advance those commodities in which shortages were expected because such announcements have the effect of accelerating buying. He thought that the Office of Price Administration should be advised informally to discontinue the practice. Mr. Fleming also thought that the inclusion of charge accounts under Regulation W would cause endless mechanical difficulties of administration and enforcement and would impose a tremendous amount of additional clerical work upon a class of retailers which has never been subject to regulations heretofore. He suggested that, if the Board decides to include charge accounts under the Regulation, it be made applicable only to "listed articles" and that a penalty interest rate be required on all accounts not paid within a specified period. He said, however, that he would prefer to see consideration of the proposal deferred until after the tax program has been determined by Congress.

Mr. Kurtz stated that he was also of the opinion that the Canadian system of regulating consumer credit encouraged the spreading of debt and that the inclusion of charge accounts under Regulation W would stimulate buying and slow down payments. He also thought that the proposal would cause a great deal of ill will toward the Federal Reserve System. He indicated, however, that if the Board should decide to take action along those lines, he would prefer to forego requiring cash down payments and to confine the restrictions to freezing charge accounts not paid in sixty days.

Mr. Ransom stated that the Regulation is experimental and that the list of articles has become less realistic than it was in the beginning. He said that originally the Board could have taken a negative approach to the problem of regulating consumer credit and proceeded along the lines followed by Canada, i.e., regulating credit for the purchase of almost all commodities except food, clothing, fuel, drugs, etc., but since the Board had not done so it might be better to go forward on the basis of broadening the scope of the Regulation and adding to the list of articles. He said that he felt there was a definite need for perfecting the machinery which would enable the Board to administer the Regulation effectively even though the list of articles was not changed until the government wants to cut down drastically the demand for given articles. He said that the Board could regulate charge accounts on listed articles in two ways, namely, (1) require identical down payments on charge accounts as is done on instalment accounts, and (2) freeze charge accounts which are not paid within a specified number of days. Mr. Ransom went on to say that in the event it should be decided to include charge accounts under Regulation W, the number of registrants would be increased from approximately 160,000 to 300,000 and that this number would be doubled if the Regulation were applied to everything but bare necessities. He said it was his view that as time goes on Regulation W will either be abandoned or the coverage broadened very materially.

In response to a question by Mr. Brown as to the source of the pressure for further modification of Regulation W at this time, Mr. Ransom stated that it came primarily from the Office of Price Administration and the War Production Board. He said it was the feeling of the Office of Price Administration, for example, that action by the Board in tightening Regulation W would be very helpful in relieving that Office of the necessity for rationing certain commodities. Mr. Ransom stated he thought that before this country wins the war, credit will be drastically curtailed and the standard of living will be very much lower than at present. It is therefore important, he said, to get Regulation W in working order to meet any contingency. He recognized that Regulation W would have loopholes regardless of what was done, but said that this was also true of rationing.

In response to a further inquiry by Mr. Brown as to whether there was any possibility that furniture would be eliminated from among the "listed articles" in the Regulation, Mr. Ransom said that he did not think so.

Mr. Lichtenstein reported that following the last meeting of the Board with the Federal Advisory Council it had been determined that the Executive Committee of the Council would meet with the Board on the second Thursday of each month (with the possible exception of

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one or two summer months) in which the regular statutory meetings of the Council were not held, but that subsequently one of the members of the Council found that the day agreed upon would not be satisfactory to him and it was now proposed that such interim meetings he held hereafter on the third Wednesday of each month. He indicated that it was his understanding that this was satisfactory to those members of the Executive Committee who were present at this meeting and that as soon as he had had an opportunity to clear the matter with Messrs. Harrison and Huntington he would advise Mr. Morrill finally whether the new meeting day would be agreeable.

Thereupon the meeting adjourned.

Assistant Secretary.

Approved:

Vice Chairman.