A meeting of the Board of Governors of the Federal Reserve System with the members of the Executive Committee of the Federal Advisory Council was held in Washington on Wednesday, June 3, 1942, at 2:30 p.m.

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

Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Thurston, Special Assistant to the Chairman
Mr. Thomas, Assistant Director of the Division of Research and Statistics

Messrs. Brown, Harrison, Kurtz, Huntington, and Fleming, members of the Executive Committee of the Federal Advisory Council

Mr. Lichtenstein, Secretary of the Federal Advisory Council

Mr. Brown stated that it was assumed that the bill which was introduced on June 1, 1942 by Mr. Steagall (H.R. 7158) to amend the Federal Reserve Act, was offered at the suggestion of the Board of Governors. He said that, in the opinion of the members of the Executive Committee, section 1 of the bill, which changed the grouping of the Federal Reserve Banks for the purpose of electing representative members of the Federal Open Market Committee, was an improvement over the existing situation in that it solved the problem of the continuous representation of the Federal Reserve Bank of New York on the Committee, but that since under the new arrangement Chicago and Cleveland would be grouped together, the difficulties that had been experienced in the

past where only two banks were in a group would not be eliminated by the bill.

With respect to the second section of the bill which would amend section 19 of the Federal Reserve Act to permit changes in reserve requirements for banks in central reserve cities without reference to reserve requirements for banks in reserve cities, Mr. Brown stated that the suggestion had been made that it would be desirable to provide in the bill that required reserves for banks in central reserve cities could not be reduced below those required for banks in reserve cities or increased, on the basis of percentage points, to more than 50 per cent above the requirements for banks in reserve cities.

In response to an inquiry from Mr. Ransom as to whether Chicago should be included with New York as a central reserve city, Mr. Brown replied in the affirmative, stating that the amount of bank deposits held by Chicago banks, the amount of financing done by those banks throughout the nation west of the Allegheny mountains, and the amount of Government securities being taken by the banks were ample justification for the classification of Chicago as a central reserve city.

Mr. Ransom stated that in the interest of flexibility, he would prefer to have New York banks in one classification for the purpose of reserve requirements and the Chicago banks in another, and this comment was followed by a discussion of the reasons why the New York banks would not be agreeable to such an arrangement, the principal one being the fear that if these banks stood alone an attempt might be

made at some future time to penalize New York banks through an unjustified increase in required reserves.

Mr. Ransom said that consideration of amendments to the law could not be approached in an atmosphere of distrust of the agencies of Government without writing into the law every possible restriction, and that it was becoming increasingly evident that a situation would occur in which it would be very desirable to change reserve requirements of banks in central reserve cities without changing them for banks in reserve cities or for country banks.

Mr. Ransom also questioned the desirability of attempting to change the bill at the present time. He stated that while the Board had not discussed the matter, if Mr. Brown would send the Board a memorandum setting forth the suggestion, it would be given consideration.

Mr. McKee suggested the advisability of deferring the proposed amendment until after there has been some experience with the law as it would be changed by the present bill, and Mr. Brown stated that there would be more likelihood of having the change adopted now as a limitation on the authority of the Board than there would be of imposing the limitation after the power was once granted. He also said that if the New York banks desired to follow up the matter, he would be glad to write the Board a letter regarding it, but that what he was suggesting at this time was that if the Board would agree to such a change, it was believed the New York banks would support it.

During the above discussion, Mr. Clayton, Assistant to the

Chairman, joined the meeting.

Mr. Brown stated that the members of the Executive Committee were in agreement with the third section of the proposed bill which would eliminate the requirement of section 19 of the Federal Reserve Act that no bank shall make new loans or pay dividends while its reserves are deficient.

During a further statement by Mr. Brown in which he expressed the opinion that it was undesirable to group Chicago with one other Federal Reserve Bank for the purpose of electing a representative member of the Federal Open Market Committee, Mr. Bethea withdrew from the meeting.

Mr. Brown then said he understood that the suggestion had been made that another section be added to the proposed bill which would provide for the absorption by the Federal Deposit Insurance Corporation of the cost of one examination each year of insured banks, that the Federal Deposit Insurance Corporation and the Comptroller of the Currency were favorable to the proposal, but that the Board had objected to its addition to the bill.

Mr. Ransom stated that the matter had been taken up with him by representatives of the American Bankers Association, but that it was felt that if this addition were made it would open the bill to a number of other changes which had been considered but which it was felt should not be included in the bill at this time, that he had suggested to the representatives of the American Bankers Association

that this amendment be put in a separate bill, and that Mr. McKee had suggested that the amendment be in a form which would require only one examination each year, leaving it to the discretion of the examining authorities whether additional examinations would be desirable in any particular case.

Mr. Brown said that he understood from the discussion that the Board was not opposed to an amendment along the lines suggested, but did not feel it was advisable to incorporate it in the existing bill.

Mr. Brown then referred to recent press statements to the effect that reserve requirements would be reduced and stated that the members of the executive committee were still of the opinion that there was no present reason for reducing reserve requirements either generally or in New York, that bankers in New York with whom he had talked had stated that they could get along comfortably on from $200,000,000 to $250,000,000 of excess reserves and that they could meet the situation with excess reserves of only $100,000,000. He added that if the Board felt that it was necessary to reduce reserve requirements either for the country as a whole or in New York, the members of the Executive Committee would be glad to hear a discussion of the reasons for that position.

Mr. Ransom stated that the representatives of the Federal Reserve System had maintained the position that every effort should be made to reach as many non-bank funds as possible in an effort to avoid

creating a situation in which a reduction in reserve requirements might be called for, but that if, after such an effort had been made, a change in reserve requirements appeared to be desirable the Board undoubtedly would make the change. He said substantial progress had been made in the discussions with the Treasury in working out a program and that these discussions would be continued, but that he knew of no feeling on the part of the Board that action with respect to reserve requirements was necessary at this time. He added that personally he would feel much easier about the situation if the amendment authorizing the Board to change reserve requirements in central reserve city banks had been adopted so that the Board would have flexible authority to relieve the situation in New York if that should appear to be desirable.

Following some further discussion of the possible origin of the press statements with respect to a reduction in reserve requirements during which it was made clear that the statements were not based on any information given out by the Board's offices, Mr. Harrison repeated the opinion expressed by him at the meeting of the Council with the Board on May 18, 1942, that a 3/8 per cent rate on bills or even a higher short-term rate need not affect the rate of 2-1/2 per cent on long-term Government securities. He also felt that there should be some firming of short rates if necessary in order to give the banks an opportunity to earn a living and thus protect them as

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one of the essential defense industries in a period of high taxes and substantially increased expenses.

In connection with Mr. Harrison's statement, Mr. Fleming expressed the strong opinion that unless legislation were passed it would be essential for the bank supervisory agencies to come to the aid of banks, which were not classed as essential industries, in order to prevent the depletion of their staffs for war work and military service. In that connection he added it should be recognized that the banks could not continue to carry on their essential functions of handling the deposits of the nation if they were to be denied the necessary manpower to service these deposits.

During the discussion of this point, members of the Board pointed out that neither of the bank supervisory agencies, nor the Treasury, were classified as essential activities and, therefore, were also faced with a loss of personnel.

Mr. Brown then requested Mr. Kurtz to comment on the operation of Regulation W as changed by amendment No. 4. Mr. Kurtz stated that, based on the experience of his bank with the revised regulation, he was of the opinion that there was no adequate reason for the inclusion in the regulation of cash loans up to $1,500 except when made for the purpose of purchasing listed articles. He said the regulation was extremely complicated and that while his bank had undertaken to digest it for the information of the personnel at the branches, the latter

felt that they could not avoid violating the regulation without alienation of their customers. With reference to the provision of Section 8(k) relating to insurance policy loans, he said he did not see how it would help the economy or aid credit control to put the holder of an insurance policy in a position where he could borrow from the insurance company on his policy on any terms but could borrow from a bank on the security of the policy only on condition that the loan be repaid within twelve months. He added that in the case of collateral loans a small borrower could not liquidate a loan of as much as $1,500 in twelve months without the sale of the underlying collateral. All of these features of the regulation, he said, were inconsequential from the standpoint of credit control but were causing great inconvenience and irritation on the part of the small borrower.

Mr. Ransom discussed the background of the present objectives of Regulation W and why it was believed to be necessary to include in the regulation the present provision with respect to cash instalment and insurance policy loans. He said that ample provision was made in the regulation for necessitous or emergency cases and that the Board did not see how, in view of the objective of the regulation of substantially reducing outstanding consumer debt, it could eliminate cash instalment loans as this would make it possible for a person to borrow for what might appear to be a purpose entirely consistent with the war effort and use other funds already available to him to buy goods

and thereby add to the inflationary pressure on prices.

Mr. Brown expressed the opinion that the regulation was not materially effective in reducing consumer debt and was causing more resentment than the Board realized. Mr. Ransom responded that the Board had received numerous complaints with respect to the regulation, most of which passed over his desk so that he was thoroughly familiar with the difficulties that were being caused on the part of the small borrower, and that the regulation was not directed toward measures of reform or preventing the use of credit by spendthrifts but to the reduction of all kinds of consumer debt.

At this point Chairman Eccles entered the room.

Mr. Fleming referred to the discussion at the last meeting of the Federal Advisory Council with the Board with respect to the desirability of including in the Treasury financing program a short-term, non-market issue and to the subsequent advice given to the Board that in a separate meeting of the Council a position had been taken in opposition to such an issue. Mr. Fleming stated that he had not been present during the discussion of the matter by the Council, that he felt it would be desirable to give it some further consideration, and that he would like to ask for a memorandum from the Board as to the reasons for such an issue and an estimate of the amount of funds that might be raised thereby.

At the request of Chairman Eccles, Mr. Thomas outlined the

reasons why, with a possible $35,000,000,000 available for savings in the fiscal year 1943, as compared with $12,000,000,000 last year, it might be possible, by tapping non-bank funds, to reduce the financing through the banks to a point as low as $10,000,000,000 during the fiscal year 1943. He said that if that could be done the question of excess reserves would be much less important than would otherwise be the case, and that in his opinion the problem was whether the policy adopted was one of doing everything to tap non-bank funds or continuing to try to sell securities to the banks in the larger centers on terms which appeal primarily to them. He felt that a reduction in reserve requirements at this time might actually lower short-term rates and postpone the time when it would be possible to attract short-term funds into the market.

Following some discussion of the desirability of doing as much Treasury financing as possible outside the banks, it was stated that in accordance with Mr. Fleming's request a memorandum with respect to reasons for a short-term, non-market issue would be sent to all of the members of the Federal Advisory Council.

Mr. Harrison suggested that it might be advisable, instead of issuing a five-year security redeemable on 60 days' notice, to issue six-month certificates and one, two, three, four and five-year notes, in order to avoid reluctance on the part of some corporations to purchase a five-year obligation because of the possible feeling that

redemption within that period might be unpatriotic. Chairman Eccles' response was that one of the jobs of the Victory Fund Committees would be to explain to investors why that would not be the case.

Mr. Brown stated that, so far as he could observe, the resistance of primary contractors to financing war contracts under the provisions of Executive Order No. 9112 and the Board's Regulation V, as compared with the methods of advances from the services, was stronger today than it was a month ago.

Comments were made by Messrs. McKee and Draper to the effect that as the borrowers became familiar with the procedure under Regulation V they would be more willing to do financing in that manner. Chairman Eccles pointed out that it was not anticipated that borrowing under Regulation V would be preferred by prime contractors but by subcontractors who could not get credit without some form of guarantee. He added that none of the services preferred to make advances because they do not have adequate facilities to supervise them in unlimited amounts and that, while it was realized that they would have to be made in some cases in order to prevent a slowing up of production, they would not be made as liberally as in the past.

Mr. Draper stated that approximately $140,000,000 of loans had been made since Regulation V was adopted on April 6, between 75 and 80 per cent of which was to subcontractors, and that a number of additional loans were in process.

Mr. Harrison said that he had just been advised over the telephone that a hurried survey had been made of the New York banks with respect to Bill H.R. 7156 to which reference was made earlier in the meeting and that on the whole the banks felt that the bill was a good one. The banks definitely favored the first and third sections of the bill, he said, and felt that the flexibility with respect to changes in reserve requirements as provided in section 2 was desirable, but that unless a formula could be adopted limiting changes in reserve requirements in central reserve cities in relation to requirements in reserve cities, it would be better to have the authority vested in the Federal Open Market Committee, not because of any distrust of the present Board of Governors but because of the possibility that in another period and under different conditions reserves might be increased in New York and Chicago and lowered in the rest of the country for purposes other than monetary control. It was also felt, Mr. Harrison said, that it might be difficult to devise such a formula and question had been raised whether it would be possible to include in the bill other amendments such as the exemption of Government deposits from Federal Deposit Insurance Corporation assessment, provision for only one examination a year, and exemption of Government deposits from reserve requirements.

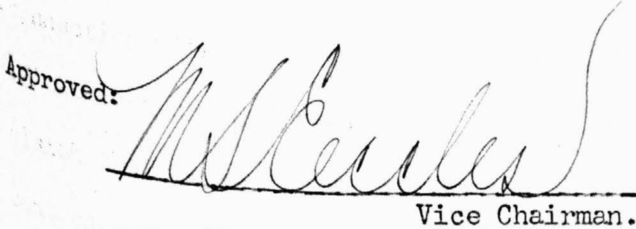
Chairman Eccles stated that all of the amendments referred to by Mr. Harrison had been considered when the bill was being drafted, but that because of their possible controversial character it was

felt that they should not be included in the present bill, the three sections of which related to matters which were not of a controversial character.

Thereupon the meeting adjourned.

Assistant Secretary.

Approved:



Vice Chairman.