A meeting of the Board of Governors of the Federal Reserve System with members of the executive committee of the Federal Advisory Council was held in Washington on Wednesday, August 5, 1942, at 10:30 a.m.

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

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Thurston, Special Assistant to Chairman

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

Mr. Lichtenstein, Secretary of the Federal Advisory Council

Question was raised with respect to the problem of administration and expense that would be placed on banks by the current revenue act in the form in which it passed the House, which provides for a withholding tax at the source on wages, dividends, and coupon interest including coupons on taxable United States issues.

In this connection, Mr. Szymczak read a copy of a report which he had received under date of July 28, 1942, from Mr. Sihler, Vice President of the Federal Reserve Bank of Chicago, of a meeting held at the Treasury on July 27, which was also attended by Mr. Willis, Assistant Vice President of the Federal Reserve Bank of New York, at which procedure under the proposed act was discussed.

Mr. Ransom stated that the Board as such had not considered this problem but that copies of a memorandum prepared under date of July 27, 1942, by Mr. Mylander, Chairman of the Committee on Taxation of the American Bankers Association, on the subject had been received, and that he had suggested to Mr. Needham, General Counsel for the American Bankers Association, in a discussion of the matter that, inasmuch as there was general sympathy with the withholding tax, the effective way of meeting the procedure proposed in the pending legislation would be to suggest a substitute which would be more practicable from an operating standpoint.

Mr. Brown expressed the opinion that the bill as passed by the House would place a burden of administration and expense on the banks which it would be difficult if not impossible for them to carry.

Mr. Fleming felt that the problem went beyond the question of expense, that it appeared that the banking system would be loaded with more and more work at the time they were losing necessary personnel for war service, and that unless there was some way of meeting that situation the banking system would break down.

Mr. Huntington was concerned with the reaction of the public to the withholding of small amounts in connection with the payment of coupons on Government securities and thought that the law as now proposed would have a definitely adverse effect on sales of such securities.

During a general discussion of the pending bill and the difficulties that would be encountered by the commercial banks and the Federal Reserve Banks thereunder, Mr. Ransom read portions of Mr. Mylander's memorandum.

Chairman Eccles raised the question as to what, if anything, might be done by the Board in the matter, and in the discussion of this question there was unanimous agreement that, although the withholding tax might be applied in certain fields as was being done in England, the proposed legislation, at least in so far as it related to the application of a withholding tax to interest on bonds, would raise serious administration and expense difficulties for the banking system, including the Federal Reserve Banks, and that in these circumstances the Board would be justified in expressing its position to the Treasury and to Congress on the matter.

Chairman Eccles said that it would be his suggestion that the Board address a letter to the Chairman of the Senate Finance Committee setting forth in simple layman's language the important objections to the present legislation and the reasons it was felt the procedure outlined therein would not be practicable, it being understood that a copy of the letter would be sent to the Treasury so that the Treasury would know what the Board was doing and what its views were. Other members of the Board indicated agreement with Chairman Eccles' suggestion.

Mr. Brown stated that, on the basis of the information available, the members of the executive committee of the Federal Advisory Council felt very strongly that no change should be made at the present time in reserve requirements of member banks.

Mr. McKee stated that he was not in agreement with this position.

Chairman Eccles said that it would be helpful to the Board if, when the Council or its executive committee had recommendations of this character to submit to the Board, it would submit them in writing with a statement of the reasons therefor.

Mr. Brown referred to the previous discussions of the question whether the Council should prepare written recommendations before discussing them with the Board, and Chairman Eccles said that his suggestion did not contemplate formal resolutions which the Council necessarily would expect to have published but rather written statements of the Council's position on matters which it had discussed for presentation and discussion with the Board, after which determination could be made by the Council whether the recommendations should be put in the form of formal resolutions which might be published. The purpose of his suggestion, Chairman Eccles said, was to avoid general discussions at the monthly meetings with the executive committee which would not be productive of effective results.

Mr. Brown referred to the provisions of section 12 of the Federal Reserve Act which authorize the Federal Advisory Council to call for information and to make recommendations with respect to certain matters, and stated that without such information it was difficult for the Council to know what the Board was thinking, particularly during the war period when conditions were changing very rapidly, and that the idea of the Council was that the Board wanted its advice with respect to matters affecting the banking system.

Chairman Eccles said that the Board was glad to get that advice, and that it would be helpful in the discussions of the Board with the executive committee if it would furnish the Board with an agenda of the matters to be discussed, so that the Board would be advised in advance what subjects were to be considered and be prepared to discuss them.

Mr. Brown referred to the fact it had been the practice of the Council before each of its regular meetings to ask the Board if it had any topics that it would like to have the Council discuss, and said that for two years or more the Board's response had been that it had nothing to suggest. He said that there must be a number of matters continually before the Board which are of vital interest to the banking system, and that it would seem that the members of the Council should be advised in advance of what the Board was considering.

Chairman Eccles' response was that in his opinion it would be a mistake for the Board, in advance of formal action, to advise the Council of actions that were under consideration. He added that it had been his experience in the past when that was done, and the

Council was not in favor of the action contemplated, the members brought influence to bear indirectly to block action. He felt it was entirely in order for the Board to have the advice of the Council so that in reaching its decisions it could be fully informed as to the position of representatives of the banks on matters affecting them, but that it would not be practicable for the Board to discuss with the Council, prior to action, open market policy, changes in reserve requirements, and other important matters.

Mr. Ransom suggested that the Council was authorized to call for information but that there was no requirement in the law that in furnishing such information the members of the Board should express their own views, and that if, for instance, the Board were contemplating immediate action on a change in the discount rates it should refrain in any discussion of that matter with the Council from any expression of the Board's conclusions. He also suggested that a workable arrangement would be for the Board to give the Council such information as it might ask for and to have a full discussion with the Council on pending matters, with the understanding, however, that there was a definite responsibility on the part of the Board not to disclose what its conclusions might be.

Mr. Brown expressed the opinion that if the Council were going to be able to give the Board any advice that was worth while it would be necessary for it to have an expression of the Board's views, together with reasons that would be taken into consideration in reaching a decision, which would not need to include a statement of the Board's conclusions. He said that to be called to Washington and to hear read for the first time some regulation that had obviously been under discussion for a long time meant that the Council would have no function to perform, and that, inasmuch as it was a statutory body, it should be in a position to express opinions with respect to matters before the Board, and should be informed as to what those matters were --not necessarily what the Board's opinions were or what their conclusions might be.

Mr. McKee said that he was of the opinion that reserve requirements of member banks in central reserve cities should be reduced at this time for the reason that a substantial part of existing excess reserves of banks outside of New York and Chicago would continue to be held idle irrespective of action by the Board on reserve requirements because (1) banks with low capital ratios would continue to maintain a large cash position, and (2) many banks were maintaining abnormal balances with correspondent banks in order to take care of collection charges. He felt that if these two conditions could be corrected a large amount of bank funds would be released for investment in Government securities and the necessity for a change in reserve requirements could be delayed.

Mr. Fleming suggested that two things could be done to broaden the distribution of Treasury bills, (1) an increase in the bill rate to 1/2 per cent, and (2) a program under which the members of the Victory Fund Committees would undertake to educate member banks on the advantages of holding bills which under present conditions are the equivalent of cash.

In connection with the point made by Mr. McKee with respect to investments in Government securities by banks with low capital ratios, Chairman Eccles suggested that the difficulty could be met by instructions from the Federal bank supervisory agencies to their examiners to regard Treasury bills and certificates as equivalent to cash.

In response to an inquiry from Mr. Szymczak for the reasons the members of the executive committee of the Federal Advisory Council felt that there should be no change in reserve requirements at this time, Mr. Brown said that, on the basis of information available, present excess reserves were sufficient to meet the existing situation and could be still further reduced without affecting the success of Government financing, and that only when it became necessary for the System to purchase a large amount of securities, probably as much as $1,000,000,000, would he feel the time had come to reduce reserve requirements.

Mr. Fleming expressed the opinion that before reducing reserve requirements a very strong effort should be made to broaden the distribution of securities outside of banks in New York and Chicago and to nonbank holders. He feared that if requirements were reduced at this time it would result in a reduction in the short-term rate and would delay the time when the rate might be increased to 1/2 per cent.

Chairman Eccles discussed some of the reasons why the bill rate had not been increased to 1/2 per cent, and Mr. Fleming reviewed briefly the reasons for his position that such an increase would be helpful in effecting a wider distribution of bills.

In a further discussion, Chairman Eccles suggested that, instead of an arrangement under which the executive committee of the Federal Advisory Council would meet each month, meetings might be held whenever matters requiring its consideration came up.

Mr. Brown's response was that that arrangement had been in effect previously but had not worked satisfactorily, and added that the Council would give consideration at its next meeting to Chairman Eccles' suggestions for making the meetings of the executive committee with the Board productive of better results.

Mr. Fleming asked whether the Board had taken any position on the suggestion that credit be allowed, for income tax purposes, for payments on existing debts and life insurance premiums, and he was informed that the Board had not considered the matter.

Mr. Ransom inquired whether the members of the executive committee had any information as to whether, in response to the joint statement of the Board, the Comptroller of the Currency, and the

Federal Deposit Insurance Corporation with respect to the curtailment of single-payment loans in excess of $1,500 which were not subject to Regulation W, there was any disposition on the part of banks, supervisory authorities, or borrowers to reduce the outstanding volume of such indebtedness. The members of the executive committee were not able to say what the response to the statement had been and, after a general discussion of the general downward trend in outstanding consumer debt, Mr. Ransom stated that it would be very helpful if the members of the Council would be prepared at the time of their next meeting with the Board to give it such information as they could obtain relating to the extent to which single-payment loans in excess of $1,500 and real estate loans were being curtailed.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.