

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of the Board of Governors in Washington on Monday, May 24, 1943, at 10:30 a.m.

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

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Goldenweiser, Director of the Division of Research and Statistics
Mr. Smead, Chief of the Division of Bank Operations
Mr. Parry, Chief of the Division of Security Loans
Mr. Dreibelbis, General Attorney
Mr. Leonard, Director of the Division of Personnel Administration
Mr. Wyatt, General Counsel
Mr. Pollard, Assistant Chief of the Division of Examinations
Mr. Berntson, Clerk in the Secretary's Office

Messrs. George L. Harrison, William F. Kurtz, B. G. Huntington, Robert V. Fleming, H. Lane Young, Ralph C. Gifford, Lyman E. Wakefield, W. Dale Clark, and George M. Wallace, members of the Federal Advisory Council representing the Second, Third, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, and Twelfth Federal Reserve Districts, respectively

Mr. Walter S. McLucas, alternate for Edward E. Brown representing the Seventh Federal Reserve District

Mr. Walter Lichtenstein, Secretary of the Federal Advisory Council

Mr. Harrison stated that Chairman Eccles had stated that he had an appointment at the White House this morning and would be unable to be

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present at the beginning of this meeting but would come in as soon as he returned.

Mr. Harrison then said that the first topic the Federal Advisory Council wished to discuss with the Board was the direct purchase of Treasury bills by the Federal Reserve Banks for the purpose of creating excess reserves, and that the matter had been taken up at this time to afford all the members of the Council an opportunity to express their views. He further stated that it had been voted unanimously to affirm the position taken by the executive committee at its meeting on April 7, 1943, that it would be unnecessary and perhaps unwise and dangerous to pursue a policy of direct purchases of bills for the purpose of creating excess reserves for the reason that, with the country so inflation-minded and with so many Government agencies taking action to check inflationary developments, the whole program might be seriously affected if the Federal Reserve System did the one thing which symbolically implied an inflationary movement.

Mr. Szymczak referred to the change in the member bank reserve picture since the adoption of legislation removing the requirement of reserves against war loan deposits, and Mr. McKee inquired whether the Council's position would be the same with respect to direct replacements of maturing securities held in the System account. Mr. Harrison replied that this point had not been discussed specifically but that the opinion of the Council had been definitely limited to direct acquisitions of bills for the purpose of creating excess reserves which would not be the purpose of direct replacements of maturing securities.

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Mr. Harrison also stated that some members of the Council felt that there might be an element of risk in the uncontrolled development of war loan deposit accounts, especially in small banks that were unable to protect themselves against wide fluctuations in such accounts, that some banks already held large amounts of long-time bonds that might not be the best collateral to liquidate to pay a war loan deposit, and that, while the Council recognized that whatever the collateral it would be eligible as a basis for borrowing and that member banks need not be unnecessarily "pinched", this might not be true so far as nonmember banks were concerned. He made the further statement that the arrangement for a definite schedule of calls on smaller war loan accounts would be helpful and might be a complete answer because it would put the banks on definite notice as to when withdrawals would be made.

In connection with Mr. McKee's comment that education of the banks in this respect would be of considerable assistance, Mr. Harrison suggested that, if the smaller banks could be encouraged to have their war loan deposit collateral composed of at least a percentage of bills and the balance in maturities of within one year, the risk would be minimized.

Mr. Harrison made the further statement that one of the members of the Council had suggested that consideration be given to the advisability of providing more excess reserves through a reduction in reserve requirements. He said that that particular member of the Council was not present at the meeting of the Council yesterday, but that those who were present were of the unanimous opinion that at the present time

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there was no need to change reserve requirements, that such action probably would be inappropriate until the general situation throughout the country was such that over-all action was required, that at the moment it would be a mistake to establish lower reserve requirements for central reserve cities than for reserve cities but that open market operations, which had been very intelligently handled, should be continued as in the past, and that, if there were further pressure for reserves, there would be no objection to the banks borrowing from the Reserve Banks.

Mr. McKee questioned whether all the reserves needed by member banks should be supplied by open market operations or whether increases in currency should be offset by changes in reserve requirements.

The considerations that would determine policy in this field were discussed, and Mr. Ransom suggested that it was likely that a situation would exist in which all three available sources of reserves, i.e., open market operations, reductions in reserve requirements, and member bank borrowing, would have to be used.

Mr. Harrison then stated that Mr. Wakefield had suggested that consideration be given to working out a procedure for the cancellation of Government contracts at the end of the war. He went on to say that there would be a great flood of cancellations when the war was over which would necessarily be confusing and in some instances damaging to many corporations, and that most of the Council members felt that if before that time a formula were adopted, such as the immediate payment of a certain percentage of the contract with a smaller payment to be made later, a considerable amount of trouble might be avoided. Mr. Harrison

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said that the Council felt that if consideration was not already being given to the problem it would be an appropriate subject for the Board to suggest to the proper agency of Government.

Mr. Draper said that the problem was being worked on in connection with Regulation V loans and that a procedure would be worked out for them, but that they represented only a very small percentage of total war contracts, and that an attempt should be made to work out a general program.

Mr. Wakefield pointed out that it was most important that before the end of the war there be a definite understanding with respect to the treatment of war contractors, that when a contract was canceled the contractor might have to deal with different people from those with whom he dealt when negotiating the contract, that these new people would assume that it was their obligation to make the best deal possible for the Government in the cancellation, that this would result in disagreements and misunderstandings, and that this might mean long delays in final settlement.

Mr. McKee stated that he was concerned with the question of fair treatment in cancellations. He also said that there was some indication that contractors were negotiating guaranteed loans regardless of whether they needed the funds so that in the event of cancellation they could get a waiver of interest, and that, while the services might not be willing to make commitments for that purpose, he was inclined to feel that it was a good arrangement in cases where the contractor was entitled to some relief.

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Mr. Wakefield explained that he had suggested that consideration be given to this problem, not because it was within the province of the Board, but because the more interest that could be created in the problem as a real opportunity to avoid postwar stagnation and shutdown the better it would be, and, knowing that the Board was in touch with the agencies concerned, he felt it could stress the point that some plan should be devised before the end of the war.

Mr. McKee said that the Presidents' Conference had appointed a committee to consider this and other matters in connection with Regulation V loans and suggested that the Council might also wish to appoint a committee which could make suggestions to the Presidents and the Board in the interest of coordinating an approach to what might be done.

Some of the members of the Board, although they agreed that the matter should be studied, questioned whether much could be done on it at this time.

Mr. Harrison then stated that a related question and one in which Mr. Fleming was particularly interested was whether, with the possibility of a continued rise in prices, increased taxes, and renegotiation and cancellation of contracts, it was too early for industry itself to take steps "to put its own house in order". It was felt, he said, that one of the things that could be done was to encourage corporations to anticipate taxes and accumulate reserves through the purchase of tax anticipation notes. He also said that some members of the Council had done a considerable amount of work in that field and that generally it had been well received.

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Mr. Fleming said that he was concerned because bank capital could not possibly keep pace with rising deposits, that price increases and the need of funds to enable industry to return to peace-time production would make a substantial borrowing from banks necessary, and that there should be a campaign of education to get corporations and individuals to build up reserves for taxes and postwar adjustments and to eliminate from their statements as many uncertainties as possible so that they would be in a position which would enable banks to extend them credit. He felt that if this were not done there might be a wave of antagonism against banks because of misunderstanding as to why loans were not made.

Mr. Draper suggested that the committee for economic development, which is under the auspices of the Business Advisory Council of the Department of Commerce, might take up that problem. Mr. Fleming responded that the committee was already considering the problem, but that it would be helpful if the Board or the Reserve Banks could give any impetus to the suggestion.

Mr. Harrison then referred to the manpower problem of the banks which had been discussed at previous meetings of the Council with the Board. He said that the Council still felt that if the working hours of banks were increased to 48 per week sufficient manpower would not be saved to compensate for the extra work and expense involved, that most of the banks represented on the Council, especially those in critical areas, had shifted their personnel to a point where now only 35 to 40 per cent of their employees were men with the remainder being women, and that it was difficult to get women to work 48 hours a week.

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Mr. Fleming pointed out that in the Washington area 76-1/2 per cent of the banks' employees were women as compared with approximately 30 per cent two or three years ago, and that it was impossible to work all the women 48 hours since many of them were married and had to shop for their families. He stated further that there did not seem to be any definite policy in the War Manpower Commission, that the matter was being left to the regional directors for decision, and that in view of the extra work being performed by the banks for the Government, including war financing and ration banking, they should be treated with some consideration.

Mr. McKee expressed the opinion that the American Bankers' Association should take the matter up with the War Manpower Commission, and said that if the banks themselves could not convince the Commission that they were entitled to classification as essential activity the Board of Governors would not be able to do so. Mr. Fleming questioned whether that was the case.

Mr. Szymczak suggested that the bank supervisory agencies did have an obligation to do what they could to help, and Mr. Wakefield said that although the Board could not force a decision an expression of its views combined with those of the banks would have an effect.

Mr. Ransom asked what results the banks had been able to get. Mr. Fleming said that in the Washington area the banks had been given a temporary respite pending the filing of schedules, and Mr. Young stated that satisfactory arrangements had been made in his district

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with the regional directors of the War Manpower Commission at Savannah and Macon, Georgia.

Mr. Ransom inquired whether an effort should be made to put the problem on a national rather than a regional basis, and all of the members of the Council indicated that such an effort should be made.

Mr. Harrison stated that in a previous discussion with the Council Mr. Ransom had indicated that the Board was considering several actions that appeared to be available with respect to the prohibition of the absorption by member banks of exchange and collection charges as an indirect payment of interest in violation of the Board's Regulation Q, Payment of Interest on Deposits, that while the topic was not on the program of the Council for this meeting it was a matter in which the members of the Council were interested, and that they would appreciate being advised of its present status.

Mr. Ransom said that the matter had been given careful consideration since it had last been discussed with members of the Council, that regardless of the form which the Board's action might take it appeared to be clear that it would result in the whole question of the payment of interest on demand deposits being brought up again for active consideration by Congress, and that there was a feeling on the part of some with whom the matter had been discussed, including bankers, that such a controversial question should not be raised during the war period. Mr. Ransom added that he personally had given a great deal of consideration to the question whether the problem should be raised again at this time in the light of the apparent sharp differences of opinion regarding it and that he had not reached a conclusion.

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Mr. Wakefield stated that he would like to repeat a suggestion that he had made before that, if the Board would address a letter to all member banks, in which the position was taken that the absorption of exchange and collection charges was an indirect payment of interest on deposits in violation of Regulation Q and in which the banks absorbing such charges were asked to discontinue the practice, they would readily respond to the Board's request.

Mr. Ransom felt that there would be two difficulties involved in that approach. One was that, if the absorption of exchange and collection charges were discontinued, the banks for which the charges were being absorbed would immediately undertake to get an amendment to the law permitting such absorption. The second difficulty was that the Board would have to take a definite position that the absorption of such charges was a violation of Regulation Q and the Board was under obligation to take the matter up with certain members of Congress pursuant to an understanding that the Board would not take action to change the existing situation without discussing the matter with them.

Mr. Ransom went on to say that he felt the System was under a definite obligation to defend par clearance for the reason that it was not in the public interest for banks to charge exchange, that he would be entirely willing as a member of the Board to vote for action within the power of the Board to achieve complete par clearance in the United States, but that the difficulty with the present question was whether it should be presented to Congress for action during the war period.

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Messrs. Young and Gifford expressed the opinion that there were relatively few banks that were absorbing exchange and collection charges at the present time and that if the Board requested them to discontinue the practice they would do so. Mr. Young thought that the extent to which exchange charges were being absorbed had declined materially during the last two or three years, and all of the members of the Council present who expressed themselves indicated that, if the Board took the position that the absorption of exchange charges was in violation of the prohibition against the payment of interest on demand deposits, there would not be much opposition on the part of banks to that decision.

There was a discussion of the extent to which banks were absorbing exchange and collection charges and the possible attitude of bankers toward a ruling by the Board that the absorption of such charges was an indirect payment of interest in violation of the Board's Regulation Q. During this discussion Mr. Kurtz referred to the unfavorable competitive position in which his bank was placed by refusing to absorb exchange and collection charges.

While the discussion was in progress, Messrs. Goldenweiser and Fleming left the meeting.

Mr. Ransom inquired if the Council was prepared to take the position that the Board should rule that the absorption of exchange and collection charges constituted the payment of interest within the meaning of Regulation Q, and in that connection he stated that it might be helpful to the Board if, before taking action, it could have a resolution from the Council.

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Mr. Harrison stated that the Council planned to discuss at luncheon today with Chairman Eccles (1) the separation of bank from nonbank financing in future war loan drives, (2) the discontinuance of the Series F and G war savings bonds, and (3) possibly some modification of the Series E war savings bonds, and that the Council would meet this afternoon and give further consideration to the problem of the absorption of exchange and collection charges. He said that it was expected that the executive committee of the Council would not meet during June but might hold its next meeting on July 7, and that it might be found desirable for the Council to authorize the committee to adopt a resolution expressing the position of the Council with respect to the absorption of exchange and collection charges so that it could be made available to the Board, if desired, before the next meeting of the Council. The matter was left open for future consideration.

Thereupon the meeting adjourned.

Chester Morley
Secretary.

Approved:

Wm. H. Harrison
Vice Chairman.