A meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks was held in the offices of the Board in Washington on Thursday, June 21, 1945, beginning at 10:00 a.m.

PRESENT: Mr. Eccles, Chairman (who entered the meeting during the discussion of Item 3)
Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Draper
Mr. Evans

Mr. Morrill, Secretary

Messrs. Flanders, Williams, Gidney, Leach, McLarin, Young, Davis, Peyton, Leedy, Gilbert, and Day, Presidents of the Federal Reserve Banks of Boston, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco, respectively

Mr. Sienkiewicz, Secretary of the Presidents' Conference

Chairman Day, of the Presidents' Conference, said that the Presidents had considered the various suggestions on the agenda for the Presidents' Conference and had prepared a list of items to be called to the attention of the members of the Board at this time. A copy of this list had been furnished to each member of the Board yesterday. He took up each item in the following order:

"1. Destruction of Records.

"The Conference of Presidents has accepted and approved the Report of the Committee on Destruction of Records dated May 24, 1945. It asks the Board of Governors to take the necessary action to carry out the "recommendations of the Committee as to records of the Bank Examinations Department, as follows:

(1) that the Board of Governors authorize the destruction of records of the Bank Examinations Department in accordance with Schedule 1 attached to the report of the Committee; and

(2) that the Board of Governors authorize the Federal Reserve Banks to destroy in their discretion internal and inter-office records of the Bank Examinations Department described in subdivision (b) of the report, and any other records of the Bank Examinations Department which the Board feels may be disposed of after stated limited periods.

"The Conference also requested the Committee on Destruction of Records to proceed with a further study of, and to consult with the Treasury about, the fiscal agency records including those for which indefinite periods of retention are recommended in the report."

Chairman Day said that it was contemplated that a copy of the Report of the Committee on Destruction of Records would be made available to the Board. There was no discussion.

"2. Cooperation with the National Bureau of Economic Research.

"The Conference considered the request of the National Bureau of Economic Research for cooperation with the Bureau in its research projects on urban real estate financing and agricultural financing. The Bureau is undertaking these projects primarily at the behest of the Association of Reserve City Bankers and expects to raise a fund of $350,000 over a period of three years for the support of the projects.

"After discussion, the Conference agreed that, pending more specific proposals by the Bureau, the Presidents agree in principal to cooperate with the National Bureau in carrying out the proposed research projects, with the understanding that the character and extent of such cooperation between the Reserve Banks and their staffs on the one hand and the National Bureau on the other will be determined "by the nature and circumstances of each case involving such cooperation.

"This action is presented to the Board of Governors for information, pursuant to the Board's expression of its willingness to have the Board's staff cooperate with the staff of the National Bureau of Economic Research in this undertaking."

There was no discussion.

"3. Financial Aid to Small Business.

"The Conference reviewed and considered the report of its Legislative Committee. After discussion, it has reached a general agreement that:

(1) It is desirable to study further the regional investment plan as proposed by the Investment Bankers Association of America and to endeavor to develop a satisfactory and workable program; and

(2) It is desirable to review the type of legislation suggested by the Committee on Legislation in its report dated September 11, 1944 relating to the modification of Section 13b of the Federal Reserve Act. The action of the Conference of Presidents on that report was that it was in sympathy with the underlying purposes of the pending legislation but that there were fundamental questions inherent in the provision changing the location of the fund, which should have consideration."

After Chairman Day had read the foregoing statement, Mr. Ransom inquired where this statement left the matter and Chairman Day said that it did not change the situation as it had previously existed. President Davis, however, made the comment with respect to sub-paragraph (2) of the foregoing item that in reality there was no new discussion of this subject. The legislative committee of the Presidents' Conference had submitted, with its approval, a report prepared by its sub-committee which embodied the above-mentioned language.

Mr. Evans inquired whether the Presidents looked with favor on the Investment Bankers Association Plan and President Davis responded that they thought that there were some possibilities in it, but that there were substantial differences of opinion which the Presidents had not resolved by a vote.

There followed a general discussion of various phases of the Investment Bankers Association Plan, during which Chairman Eccles entered the meeting.

Chairman Eccles referred to the fact that he had made a statement on this subject before the Committee on Small Business, known as the Patman Committee, in the House of Representatives, which corresponds to the Murray Committee in the Senate. He said that the Patman Committee had held hearings in various parts of the country and had done a lot of hard work on the subject, in which they had taken a very active interest. He added that two members of the Committee were very critical of banks and of bank examination policies. They reported that in their hearings everywhere the burden of testimony was critical of bank examinations and that bankers had stated that they could not make term loans of the types necessary for small business because they were criticized by the examiners as being slow or unsound.

Chairman Eccles said that he explained to the Committee the agreement which had been reached in 1938 among the supervisory authorities, but that he recognized that the habits of individual examiners might not be easily changed and he would not be surprised if it appeared that the agreement had been ignored by some examiners under the Federal Deposit Insurance Corporation or the Comptroller's Office. However, so far as the Federal Reserve was concerned, he said that he felt sure that the examiners were adhering strictly to the examination procedure contemplated by the agreement.

Then, Chairman Eccles said, he explained to the Committee members the proposals contained in the pending Wagner-Spence Bill to amend Section 13b of the Federal Reserve Act, and said that the members of the Committee seemed to be very much in favor of that sort of an approach to the problem. Chairman Eccles said that the members of the Committee were of the opinion that it was not equity capital that was wanted by small business concerns, because they did not want to give up or share control of their own enterprises and they felt that the Investment Bankers Association proposal would involve giving up some control. They did not want to turn over such control to others or to dilute their stock ownership by sharing it with others. What they wanted was low interest rate, long-term credit which was not the type of credit that banks would provide without some form of insurance or guaranty comparable to the Federal Housing Association insured loan.

The Chairman said that he criticized the Investment Bankers Association proposal, particularly in view of the opposition that had been expressed on the part of bankers to the Government being a participant in the extension of credit, while at the same time the plan proposed, in effect, that a substantial part of the funds should come from the Treasury, and therefore they were thoroughly inconsistent; second, that the fund of $139,000,000 upon which they proposed to draw was already committed, so that it would not be available; and, third, that, if the proposed corporations took over equity capital of a business enterprise, there was a provision that they could sell it whenever they chose to sell it, which would tend to open up opportunities for monopolization rather than for the independence of little business. In other words, if an enterprise were profitable and successful, the investment corporation could immediately turn around and sell the stock, whenever it had an opportunity, to someone who would like to obtain an interest in it or possibly control of the enterprise.

Chairman Eccles reported further that he had said that one way in which to help small business was to modify the tax laws and that he had suggested that a corporation should be exempted from the payment of taxes on amounts distributed as dividends.

Mr. Williams said that he wanted to emphasize the point about taxation because casualties in small business are very heavy, and only a relatively few small business enterprises were highly successful, and they tend to become successful in a very large way, so that the tax problem will become acute. Chairman Eccles commented that the difficulties of building up an equity under present tax laws were almost insurmountable.

In the course of the foregoing discussion, Chairman Eccles commended a letter which had been sent by President Flanders of the Federal Reserve Bank of Boston to all member banks in the First District in regard to the Wagner-Spence Bill, under date of June 14, 1945, and suggested its consideration by the other Presidents.

"4. Borrowing by Banks to Increase Excess Profits Tax Base.

"The Conference discussed the question of member banks borrowing on Government securities, as collateral, for purposes of increasing 'borrowed capital' to lessen or avoid excess profits taxes. In view of existing policy with respect to loans on Government securities, and in view of the impossibility in most cases of determination by the Reserve Banks whether such borrowing is for business purposes, within the meaning of the income tax law, the Conference was of the opinion that this is primarily and largely a matter for the Bureau of Internal Revenue. The Presidents desire to discuss this matter and this opinion with the Board of Governors, in the light of the Board's letter S-843, dated April 19, 1945.

"At its meeting in February, the Conference considered this subject and the general consensus was that the practice of using Reserve credit by a bank for purposes of increasing excess profits tax base was improper, and that supervisory authorities should discourage this practice when it came to their attention. This, of course, is still the view of the Conference."

There was a considerable general discussion of the practicability of determining in each case whether the purpose was to increase the tax base or some other purpose. The discussion touched upon a number of points, including the following: (1) Cases of banks that were simultaneously buying Governments and borrowing when the circumstances would indicate that the purpose was not merely to make a profit by reason of the difference between the discount rate and the rate borne by the Governments, but also to increase the excess profits tax base; (2) Whether the preferential rate based upon Government securities maturing within one year should be eliminated or raised; (3) The Treasury financing program and the statement of policy announced by the Board of Governors in September 1939 in regard to lending on Government securities; (4) The desirability of obtaining a ruling from the Treasury as to whether the amount of such borrowing will be allowed in computing the tax base; and (5) the provision incorporated in paragraph 8 of section 4 of the Federal Reserve Act by the Banking Act of 1933, which expressly requires that each Federal Reserve Bank shall keep itself informed of the general character and amount of the loans and investments of its member banks, with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and in determining whether to grant or refuse advances, rediscounts or other credit accommodations the Federal Reserve Bank shall give consideration to such information.

There were varying opinions among the Presidents as to the feasibility of determining in all cases when member banks were borrowing for the purpose of reducing their excess profits taxes. Mr. McKee called attention to an actual case which had developed in one of the Federal Reserve Districts, where the purpose had been entirely clear, and this was discussed, and there seemed to be no difference of opinion that borrowing of that kind should be stopped. Mr. Young referred to the fact that the form of application for advances used at the Chicago Bank called for information as to the purpose of the borrowing. It was agreed that if flagrant cases should develop, the Federal Reserve Banks should not permit such borrowing and, also, that an attempt should be made to get a ruling from the Treasury. In this connection, the suggestion was made that if the Treasury would select one or more clear cases and announce a ruling, the whole problem would be disposed of.

Chairman Day raised the question whether the Board would approve at this time a raise in the discount rate, but Chairman Eccles thought that such action should be deferred until the matter had been discussed with the Treasury, because of the close relationship between such action and the Government financing program. It was understood that the Board, at the earliest opportune time, would take up with the Treasury both the question of a ruling by the Treasury on borrowings for the purpose of raising the excess profits tax base and the question of eliminating or raising the preferential discount rate.

In connection with the use of the borrowing facilities of the Federal Reserve Banks in order to reduce the excess profits tax, Chairman Eccles said that he was concerned about the vulnerability of banks when there develops in the public mind a knowledge of the increasing earnings of the banking system and a feeling that something should be done about it which might, among other things, result in special taxation on the banks. Mr. Davis felt that the fact that the Board and the Federal Reserve Banks had carried on a drive for the purpose of getting banks into a more fully invested position should not be overlooked. Chairman Eccles, however, took the position that the question under consideration related to cases where investment was not the purpose but rather a temporary use of Government securities as a base for borrowing from the Federal Reserve Banks to evade tax obligations, which would not be a proper use of Federal Reserve credit.

Mr. Gilbert said that he thought that the Federal Reserve Banks had a distinct responsibility in cases of the kind which had arisen in his District and Mr. Davis said that he felt that all of the Presidents would take the same position as that which had been taken by Mr. Gilbert. Mr. Young described a case which had come to his attention, in which the application had been disapproved, and agreed with Mr. Gilbert. There appeared to be no disagreement on the part of any of the Presidents.

"5. Regulation D - Reserve Requirements.

"The Conference discussed the proposed amendment to Regulation D under which a member bank with its head office in a non-reserve city and having a branch in a reserve city would be considered to be in a reserve city for purposes of fixing reserves. Members expressed diverse views and comments. Some of the Presidents were inclined to leave the present definition in the regulation unchanged, while a few others recognized possible abuses by some banks if the present definition is left unchanged. Beyond discussion, however, no action was taken."

Chairman Eccles said that the Board had reached a definite conclusion regarding the action which should be taken and Mr. McKee reviewed for the information of the Presidents the several situations which had been involved in reaching a decision. There was a general discussion of the various aspects of the problem.

"6. Consumer Credit.
"The Conference briefly discussed the new phase into which the Federal Reserve System is entering in the administration of Regulation W, as a consequence of reconversion. In order to improve further the existing liaison between Board and Banks, the Conference decided to establish a special committee on consumer credit to study the content and administrative aspects of Regulation W and to serve when desired as a means of consultation and a channel of communication between the Board and the Reserve Banks."

Chairman Day said that the Committee of Presidents referred to in this statement had not yet been appointed; that the matter had been referred to the Committee on Committees of the Presidents' Conference; and that, when the appointments were made, the Board would be advised. Mr. Ransom said that he wished to thank the Presidents' Conference for taking this action, and that he believed that it would be a very helpful move.

At this point, Chairman Day said that he had presented all the matters which the Presidents' Conference wished to bring to the attention of the Board at this time.

Chairman Eccles said that he had some matters which he would like to discuss with the Presidents. He then outlined the developments in a proposal which had come to his attention during a visit which he had received last Friday from Federal Loan Administrator Snyder and Mr.

Fisher, a Director of the Reconstruction Finance Corporation. This proposal would involve the substitution of the Reconstruction Finance Corporation for the Army, Navy, and Maritime Commission in relation to V and T loans. Chairman Eccles reported that Mr. Snyder and Mr. Fisher said that there had been some discussions by the Armed Services and the Maritime Commission of this proposal; that Messrs. Patterson and Forrestal had said that they would like to have the Reconstruction Finance Corporation take over their position with respect to such guaranties because they would like to get out of this function.

The proposal came as a surprise to Chairman Eccles. He said that it was presented to him, however, as a matter which would lie entirely between the Armed Services and the Reconstruction Finance Corporation and that there would be no change in the functions of the Board and the Federal Reserve Banks--it would be merely a substitution of the Reconstruction Finance Corporation for the Armed Services and the Maritime Commission. Viewed in this light alone, Chairman Eccles did not see how we could reasonably say that there was any objection, but viewed as a practical operating matter he did not see how it would work out and he did not see how the Armed Services could be eliminated, especially in the field. He did not see how the questions involved in determining the necessity of war production and questions growing out of the cancelation of contracts could be transferred to the Reconstruction Finance Corporation because it seemed to him that they would have to continue to be determined by the Armed Services. In that connection, Chairman Eccles said that Mr. Snyder and Mr. Fisher had told him that they did not wish to give the matter consideration without first talking to him about it. Chairman Eccles thereupon suggested that Federal Reserve and Reconstruction Finance Corporation staff people give the matter careful study before going further. He referred to the fact that Mr. Hinckley's organization would have to be consulted because they had certain statutory responsibilities.

The Chairman was impressed with the thought that possibly the underlying motive of the plan was to provide a continuing place for the Washington staffs of the Armed Services who had been working on this program and who would feel that the Reconstruction Finance Corporation could provide them this opportunity, and in that connection, the deferred participation plan of the Reconstruction Finance Corporation was mentioned as a function which should be tied together with the V and T loan program.

The Chairman then said that he had received from Mr. Vest of the Board's staff a memorandum which presented some information that had not come to Mr. Vest before yesterday. Mr. Vest's memorandum contained a number of extracts from a memorandum prepared by Paul Cleveland, which showed that the matter had been under discussion since last February, without the knowledge of any member of the Board or its staff. At this point the Presidents made it clear that they had not been informed.

The Chairman went on to say that First Vice President Rounds of the New York Bank was in Washington last Saturday on other business and that advantage was taken of his presence to discuss the question which had been raised on the preceding day by Messrs. Snyder and Fisher; that Mr. Rounds, in turn, had discussed it with Mr. Phelan of the New York Bank, who had been directly in charge of the V and T loan program in the New York Bank, and that Mr. Phelan had prepared an excellent memorandum pointing out substantial objections, which the Chairman read in full.

In the discussion which followed, it appeared that there was general agreement on the part of both the Presidents and the members of the Board with the views expressed by Mr. Phelan in his memorandum. Chairman Eccles then stated that since he had come into the meeting he had received advice that General Carter and Colonel Mechem wished to come and see him sometime today and Chairman Eccles assumed that this subject was what they wished to discuss. Chairman Eccles said that he felt that the procedure now in existence should not be disturbed, because it is not practical to make the proposed change; second, that if, however, it should be the decision of the Armed Services that they wish to substitute the Reconstruction Finance Corporation for themselves, then the Reconstruction Finance Corporation should take over the entire project; they should not only step into the place of the Armed Services but they should also take the place of the Board and of the Federal Reserve Banks, because the whole program would have to be run from the Washington office of the Reconstruction Finance Corporation through their own Agencies in the field and their own facilities.

Mr. McKee raised a question as to whether the transfer could be made effectively under present law and whether the Federal Reserve Banks could function for the Reconstruction Finance Corporation as a fiscal agency operation, or whether it would not require new legislation. Chairman Eccles said that, while there had not been time to give it thorough consideration, Mr. Vest was of the opinion that very likely it could be done under existing law and that he had no doubt that Paul Cleveland had thoroughly considered that question.

Chairman Eccles said that, while nothing could be done about it at this time because it is in a state of uncertainty, he would like to be able to say to Messrs. Snyder and Fisher that he had discussed the matter with the Presidents and that they were unanimously opposed to the change at this time, but that, if the final decision were reached to substitute the Reconstruction Finance Corporation for the Armed Services, they would strongly object to the proposal to use the facilities of the Federal Reserve Banks and their personnel as agencies of the Reconstruction Finance Corporation. It appeared that there was general agreement on the part of the Presidents with this position.

Thereupon the Chairman brought up the subject of the Wagner-

Spence Bill to amend Section 13b of the Federal Reserve Act. He reviewed the development of this proposal and explained its present status in Congress. Chairman Eccles said that he felt considerable doubt at this time as to the probability of its enactment.

Chairman Eccles then discussed the program to which there had been some reference in the public press for dealing with capital gains and speculative activities in the real estate field and in the stock markets. He reviewed the history of the proposals which had developed originally from fears in the Agriculture Department and the Housing Administration and on the part of Mr. Vinson, when he was Director of Stabilization, as to the effects of inflation in the farm and urban real estate markets, as well as in the stock markets. It had been pointed out that sale prices of farms and houses were increasing rapidly and a desire had been expressed for an Executive Order to curb credit in these fields by increasing down payments and taking whatever other steps with respect to credit terms might be necessary to restrain the inflationary development. At that time there were some differences of opinion as to where the responsibility should be placed, and Chairman Eccles submitted a memorandum to the Stabilization Committee, in which he felt that he had presented effectively the reasons why credit controls would not be adequate, and took the position that the problem could only be attacked through an adequate tax upon capital gains, which would reach not only transactions in which credit had been utilized, but also transactions effected through the use of cash, which could not be reached at all through credit controls. He had pointed out that there was a large volume of the latter class of transactions. The Chairman therefore had opposed vigorously the proposal to deal with the problem through credit controls. On the other hand, Mr. Vinson was not favorable to the tax approach because he believed that the necessary action could not be obtained from Congress, but it was the Chairman's view that it would be only difficult to get because it would be realized that it would be effective, which would not be the case through credit controls.

In that connection, Chairman Eccles referred to a discussion which had arisen before the Senate Banking and Currency Committee when he had appeared in support of the bill to reduce the reserve requirements of the Federal Reserve Banks, which led to the question what should be done about a capital gains tax. This discussion, however, had been relatively brief, although it had been given a great deal of prominence in the papers. Chairman Eccles said that the situation had now developed to the point where, notwithstanding his resistance to credit controls, a definite program had been developed for submission to the President. This program involved three parts: first, an Executive Order providing for the imposition of credit controls in connection with mortgages upon real estate, urban and farm; second, a raise in margin requirements in connection with stock transactions; and, third, a request to Congress to increase the holding period on capital assets from six months to three years, and possibly also an increase in the rate of tax. In that connection, the Chairman said that he felt that the present exemptions for refugees should be eliminated and that he would make that suggestion.

The program contemplated that there would be a directive from Stabilization Director Davis to the Board to increase margin requirements, but the responsibility for the program as a whole would be taken by the President. An Executive Order had been drafted by the Board's staff in consultation with counsel for Stabilization Director Davis covering the program for imposing credit controls on real estate transactions. There had arisen, however, a request on the part of the Housing Administration to exempt from the proposed Executive Order or from the regulations under the Order all new construction, and Chairman Eccles had vigorously opposed any such exemption, on the ground that the Agency charged with the responsibility for administering the proposed credit controls should not be handicapped by restrictions laid down in advance, and particularly so in the field of new construction, as to which the Chairman was strongly in disagreement with the Housing Administration. Nevertheless, it appeared likely that something might be incorporated in a statement by the President to this effect.

The Chairman said that the Executive Order under existing procedure would be sent to the Budget Bureau for clearance with interested Agencies and that Mr. Vinson had suggested that that would be the time when Chairman Eccles might record his views. He therefore proposed to prepare a report to the Budget Bureau on the program. He would not undertake to oppose the program as a whole, but would point out the ineffectiveness of the credit control mechanism alone and the various objections that would be made to it on the part of the public, together with the fact that the public would be led to expect a great deal more from credit controls than will actually be realized, particularly at this late stage. Consequently, it would be pointed out that the tax part of the program should come first, and that unless Congress is willing to recognize the whole program as one program and to pass an effective tax measure for the purpose of carrying out the proposed program, the credit controls should not be used. In this general connection, the Chairman said that reports coming in from all over the country show that the inflationary situation is becoming increasingly bad.

Chairman Eccles emphasized the necessity for treating all of this discussion as a matter of a strictly confidential nature, not to be repeated, and that it was of the utmost importance that nothing be said or done by the Federal Reserve System which might be misconstrued by others as an evidence of opposition on the part of the System to the program as a whole.

6/21/45

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.