

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Friday, April 28, 1950.

PRESENT: Mr. McCabe, Chairman
Mr. Eccles
Mr. Szymczak
Mr. Vardaman

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary

Minutes of actions taken by the Board of Governors of the Federal Reserve System on April 27, 1950, were approved unanimously.

Telegrams to the Federal Reserve Banks of New York, Philadelphia, Cleveland, Richmond, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco stating that the Board approves the establishment without change by the Federal Reserve Bank of San Francisco on April 25, by the Federal Reserve Bank of St. Louis on April 26, by the Federal Reserve Banks of New York, Philadelphia, Cleveland, Chicago, Minneapolis, Kansas City, and Dallas on April 27, and by the Federal Reserve Bank of Richmond on April 28, 1950, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Memorandum dated April 28, 1950, from Mr. Carpenter, Secretary of the Board, recommending an increase in the basic salary of Miss Alice C. Godard, a clerk-stenographer in the Office of the Secretary, from \$2,650 to \$2,875 per annum, effective April 30, 1950.

Approved unanimously.

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Letter to Mr. Diercks, Vice President of the Federal Reserve Bank of Chicago, reading as follows:

"In accordance with the requests contained in your letters of April 19, 1950, the Board approves the appointments of Harris C. Buell, Jr., Edward August Koeller, and Keefer Lientz, at present assistant examiners, as examiners, and the appointments of Raymond W. Baxter, John Walter Burhop, and Robert Joseph Hochstatter as assistant examiners for the Federal Reserve Bank of Chicago.

"Please advise us of the dates upon which the appointments become effective and also as to the salary rates not reported."

Approved unanimously.

Telegram to Mr. DeMoss, Vice President of the Federal Reserve Bank of Dallas, reading as follows:

"Reurlet 24th. Board extends to July 1, 1950, the time within which First State Bank, Bellaire, Texas, may accomplish membership."

Approved unanimously.

Letter to Honorable Maple T. Harl, Chairman, Federal Deposit Insurance Corporation, Washington 25, D. C., reading as follows:

"In response to Mr. Cramer's letter of March 28, 1950, we shall be glad to make available to your office the reports of condition of State member banks in the Federal Reserve System as of December 31, 1949 for the tabulations described in your letter.

"In view of the regular nature of the requests for these tabulations, the December and June reports will be made available hereafter upon telephone request from your office, subject to the following conditions for the maintenance of the confidential nature of these reports: (1) that the items that do not appear on the face of the report, namely, loans to farmers and real estate loans on farm land, will be furnished

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"to the Bureau of Agricultural Economics of the Department of Agriculture with the understanding that they will not be published in a manner that will disclose figures for any county or size group consisting of less than three insured commercial banks; and (2) that these same items will not be furnished the Agricultural Department of the American Bankers Association in groups consisting of less than three insured commercial banks.

"You may also place on punch-cards such additional items as you may desire for your use in making studies concerning the assets and liabilities of all insured commercial banks.

"Please advise us whenever subsequent requests are received from either the Bureau of Agricultural Economics of the Department of Agriculture or the Agricultural Department of the American Bankers Association for the tabulations of items not on the face of the report of condition, other than those named above."

Approved unanimously.

Letter to the Presidents of all Federal Reserve Banks,
reading as follows:

"Enclosed is a copy of a letter dated April 27 from Mr. James J. Maloney, Chief, Investigative Staff of the House Committee on Appropriations regarding a study of fiscal agency operations performed by the Federal Reserve Banks. In this connection reference is made to Mr. Bartelt's letter to you dated March 20, 1950 with its accompanying memorandum.

"Mr. Maloney made brief visits to the Federal Reserve Banks of New York, Philadelphia and Chicago a short time ago. We have been advised today that Messrs. LaPadula and Bernstein are planning to start their field studies with a visit to the Federal Reserve Bank of Philadelphia beginning Monday, May 1.

"This study and these visits, made by a committee of Congress rather than a Government department, agency or corporation, represent visits

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"somewhat different than the type discussed at the Joint Meeting of the Presidents and the Board June 11, 1946, and referred to in the Board's letter S-947 (F.R.L.L.S. 5571). We have, however, discussed the matter this afternoon with President Gilbert, Chairman of the Committee on Fiscal Agency Operations."

Approved unanimously.

Letter prepared for the signature of the Chairman to Mr. Stephen J. Spingarn, Administrative Assistant to the President, The White House, Washington, D. C., reading as follows:

"This is in response to your memorandum of April 27 requesting comments on a draft of a message to be submitted to Congress by the President on a proposed 'Small Business Act of 1950'. The message follows the draft of a bill, with certain modifications, which was dated April 10, 1950. This draft in turn was based on earlier versions, including one on which we commented in our letter to the Budget Bureau on March 28, 1950. Our staff has worked closely with those preparing these drafts and has endeavored to offer every assistance, and we are grateful that some of their suggestions were helpful in making significant improvements in the proposed program.

"We wish to compliment you particularly on the tone and clarity of expression of the message and we would agree with many of its basic concepts. However, we sincerely regret that we find ourselves in complete disagreement with a number of the principal features of the proposed program and cannot urge you too strongly to reconsider these features. The bill and the message will have strong appeal to many people who have little knowledge of the technical operations of finance. At the same time, it will repel many of the President's warmest supporters among those who have knowledge of actual problems of finance, and who must be counted on to make the proposed program effective. Therefore, we think it very important that the President have a topside conference immediately with his agency heads who are most familiar with the subject, and that arrangements

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"be made to counsel with the Chairmen of the interested Committees of the Senate and House, with other key members of these Committees, and with Senator O'Mahoney whose Subcommittee of the Joint Committee on the Economic Report recently looked so extensively into the problems of small business financing.

"We urge that this be done before you recommend to the President that he commit himself to such a program. The language of the message clearly indicates that what is contemplated is the establishment of purely private profit-seeking companies to provide capital financing to small business. Any keen student of finance, however, when he analyzes the specific technical and interlocking features of the bill, will quickly reach the conclusion that it would be difficult to interest real investors in these proposed national investment companies.

"In its letter of March 28, 1950, to the Budget Bureau, the Board took particular exception to the provision that would have permitted the proposed national investment companies to finance themselves through the issue of debentures insured by the U. S. Treasury. The considerations that led to that position apply equally to the provision that has now been substituted, namely, that the RFC be permitted to buy the debentures of the proposed companies. The RFC draws on the Treasury for its funds. To finance such companies through the RFC would merely result in the issuance of direct Treasury obligations in the market rather than the issuance of obligations insured by the Treasury.

"On the basis of our extended studies and consideration of the draft legislation covered by this message, we believe that the proposed small business financing program will meet with strong public criticism on four fundamental grounds, as follows:

1. Government financing of speculative institutions which are to operate in the highly and inescapably speculative area of risk financing.
2. Further expansion of Government credit, with resulting additions to the supply of liquid assets, in order to aid purely private business ventures.

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- "3. Failure to provide an effective separation between the function of supervision of financing and facilitation of financing, on the one hand, and the function of business promotion, on the other.
4. Failure to safeguard the Administration from charges of political favoritism in allocating resources among competing businesses, particularly small businesses that are competitive with each other.

"We wonder whether those concerned with the preparation of this bill have fully considered the financial implications of the national investment companies as proposed in the bill and justified in the message. Who is expected to purchase the shares of these companies? Will this expectation be justified? The purchaser of the equity shares will carry all of the risk of losses while the RFC will hold the senior capital position. The RFC will share none of the risk of any investment company until the stockholders equity has been eliminated.

"Investors will not risk their funds in such a venture unless they are fully satisfied that the new investment companies will be free from any suspicion of promotional influence in the placing of their funds. They will be particularly alienated by point five (that begins on page 15 of the message) which goes out of its way to violate the time-honored maxim that 'No man can serve two masters' and the dictum of the late Justice Brandeis that 'The best bargains are made when buyer and seller are represented by different persons.' Instead, point five is built on the concept that not only (1) the promotion of small business expansion, but also (2) the chartering and supervision of institutions engaged in the risk financing of small business, and, in addition (3) the senior financing of these institutions are all to be combined in the same agency and subject to one overriding decision. These are three distinct functions that require independent evaluation.

"As a result of our many conferences during past months with progressive leaders in banking, insurance, and business in which the broad subject of financial aid to small business has been freely discussed, we

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"are of the opinion that prudent investors will be loath to hazard their savings, or the funds entrusted to them, in the risk securities of investment companies so organized, promoted, supervised, and financed. We would fear that the few such companies, if any, which might be organized would tend to be seriously under-capitalized and if they operated at all broadly would become essentially subsidiaries of the RFC, i.e., direct Government agencies engaged in risk financing. This result would be in direct contradiction to the type of institution pledged by the President in the draft message.

"In addition to these over-all observations, we have a specific comment which we would like to make.

"Much of the confidence of the financial community in the Federal Reserve System rests on its faith in the System's objective approach to problems of finance. One of our primary concerns always must be to preserve that confidence in order that the Federal Reserve can properly fulfill its responsibility to the Government and to the people. If the present serious defects of the bill are to be retained, we would prefer to have eliminated the provisions relating to participation by the Federal Reserve Banks in financing the proposed investment companies.

"We regret exceedingly that it is necessary to bring out these negative points because the Board and its staff have long had a sincere appreciation of the financing problems of small business and have devoted extraordinary effort to a consideration of the various proposals advanced, both within and outside of Government, for their solution. Most of the sponsors of these proposals have consulted at one time or another with the Board's staff. It would be very embarrassing to us to be summoned by Congress to discuss important features of this bill when it is so obvious that a more practical and successful program could be evolved."

Approved unanimously.

Letter to Mr. Roger W. Jones, Assistant Director,
Legislative Reference, Bureau of the Budget, Washington 25, D. C.,
reading as follows:

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"This refers to your letter of April 13 requesting comments on a proposed draft bill prepared by the General Services Administration entitled 'To create a Government corporation to operate cafeterias and conduct certain other activities in Government buildings and on Government property.'

"The matter has been discussed with Mr. Scott Moore of your Bureau and Mr. L. S. Frick of the General Services Administration to whom Mr. Moore referred us, and it is understood from them that the bill definitely was not intended to affect in any way the Board or the operation of the Board's cafeteria. While it is believed that the present draft probably carries out this intention, it seems desirable to clarify this in certain respects and there is attached a memorandum suggesting certain amendments for this purpose. The amendments have been discussed generally with Mr. Frick, and although it has not been possible in the available time for him to study and advise of his agreement on the particular language of each amendment, we understand that he is in general agreement with their substance and, to a large extent, with their language.

"On the understanding indicated above as to the intention of the draft, and with the incorporation of the suggested clarifying amendments on the point, the Board would have no objection to the bill."

Approved unanimously.

Letter to Mr. Roger W. Jones, Assistant Director,
Legislative Reference, Bureau of the Budget, Washington 25,
D. C., reading as follows:

"This refers to your letter of April 5, 1950, to Chairman McCabe, requesting the views of the Board with respect to a draft of a bill proposed by the Treasury Department which would amend the last paragraph of section 5153 of the Revised Statutes, relating to the authority of national banks to give security for funds deposited by public officials.

"The provision of the statute which the proposal would amend now authorizes any national bank to give

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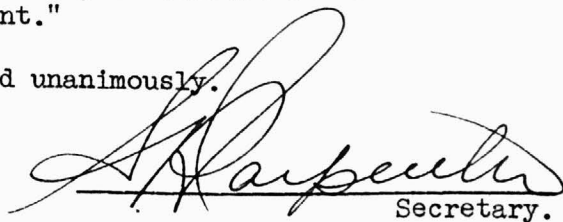
"security, of the same kind required by State law for State banks, to secure deposits 'of public money of a State or of any political subdivision thereof'.

"The proposed bill would amend the law in this regard to authorize any national bank to give security, of the same kind required by State law for State banks, to secure deposits of 'any funds' by States or their political subdivisions, agencies or instrumentalities, including officers, employees, or agents thereof acting in their official capacities.

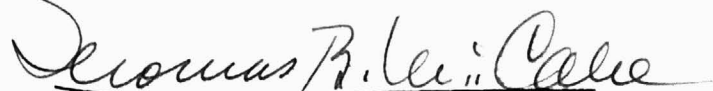
"This proposal does not involve any change in basic policy with respect to the furnishing by national banks of security for funds deposited with them by public officials. The existing law has been somewhat narrowly construed by court decisions; and the proposed bill would clarify and expand to some extent the authority of national banks to give security for funds deposited by local public agencies and officers. The effect of the proposal would be to carry out the purpose of the existing law by placing national banks in this respect on a more equal basis with State banks.

"In the light of the experience of the early 30's and the purposes of the establishment of Federal deposit insurance, the Board believes that there is a fundamental inconsistency in continuing the authority to prefer one class of depositors over another by diverting a part of the assets of the bank to secure the payment of the claims of the preferred class in full, and that this inconsistency would be accentuated by liberalizing the provisions of law on this subject. However, if after considering this fundamental question of policy it should be the view of Congress that the existing discrimination among depositors should be maintained, it would, of course, be consistent to enact the proposed amendment."

Approved unanimously.


Secretary.

Approved:


Chairman.