MINUTES OF MEETING

of the

FEDERAL ADVISORY COUNCIL

May 19-21, 1940

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

May 19, 1940

The second statutory meeting of the Federal Advisory Council for 1940 was convened in Room 836 of the Mayflower Hotel, Washington, D. C., on Sunday, May 19, 1940, at 2:00 P. M.

Present:

Mr. Thomas M. Steele	District No. 1
Mr. Leon Fraser	District No. 2
Mr. Howard A. Loeb	District No. 3
Mr. B. G. Huntington	District No. 4
Mr. Charles E. Rieman (Alternate for Mr. Robert M. Hanes)	District No. 5
Mr. Ryburn G. Clay	District No. 6
Mr. Edward E. Brown	District No. 7
Mr. S. E. Ragland	District No. 8
Mr. John Crosby	District No. 9
Mr. John Evans	District No. 10
Mr. R. Ellison Harding	District No. 11
Mr. Paul S. Dick	District No. 12
Mr. Walter Lichtenstein	Secretary

On motion duly made and seconded, the minutes of the Council meeting of February 18-20, 1940, copies of which had been previously sent to the members, were approved.

The Secretary stated that Mr. Hanes was unavoidably absent and his place was being taken by Mr. Charles E. Rieman, President of the Western National Bank of Baltimore, as alternate.

The President stated that he would offer to the Board of Governors of the Federal Reserve System in this time of crisis all possible aid of the Federal Advisory Council, its Executive Committee, and the individual members.

Attention was called to the fact that one of the two questions propounded by the Board of Governors, reading "What are the business prospects for the next 90 days and in the Council's opinion do such prospects justify any change in the System's present banking and monetary policies?" was impossible of answer at the present time owing to the confusion and uncertainty existing in the world, and the Board, therefore, should be asked not to insist upon an answer to this question at this time.

Mr. Fraser submitted a draft of the answer to be made to the Board of Governors to the question propounded to the Council by the Board of Governors dealing with "modification of the policy of extreme easy money." Mr. Fraser pointed out that a few days ago there appeared in the *Federal Reserve Bulletin* an article by Dr. E. A. Goldenweiser, Director, Division of Research and Statistics of the Board of Governors, dealing with the "easy money" policy.

At 3:00 P. M. Mr. D. J. Needham, General Counsel of the American Bankers Association, joined the meeting.

Mr. Needham discussed pending legislation of interest to the banking system. He explained at some length the changes in present law contemplated by the so-called

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Steagall bill (H. R. 8638), which is intended to reduce the assessment of the F.D.I.C. from one-twelfth of one per cent to one-fourteenth of one per cent and increase the amount of insurance for the benefit of each depositor from $5,000 to $10,000. It is also planned to remove the Comptroller of the Currency from the Board of the F.D.I.C. Mr. Needham doubted whether this bill would be enacted into law at this session of Congress.

Mr. Needham was also of the opinion that the Jones-Wheeler bill (H. R. 8748 and S. 3509) would not be enacted into law, certainly not in its present form. Much opposition has developed in reference to many provisions of the bill. It is conceivable that both the Jones-Wheeler bill and the Steagall bill may be adopted in very much revised forms.

The Wagner Committee has issued a questionnaire in connection with the proposed investigation of the banking structure of the country.

The Brown bill (S. 2045), intended to abolish the office of Comptroller of the Currency, has not made any progress toward passage.

Mr. Needham left the meeting at 3:35 P. M.

It was moved by Mr. Steele, seconded by Mr. Huntington, to adopt in principle, but subject to amendments, the document submitted by Mr. Fraser as an answer to the question dealing with "easy money."

A discussion took place regarding Mr. Steele's proposal made at the February meeting of the Council to restore the free circulation of gold. Mr. Steele stated that in view of changed conditions, no action should be taken on this matter at present. There was some disagreement expressed, but an informal poll of the Council being taken, it was found that nine members were opposed to any action in respect to the free circulation of gold at this time.

Mr. Steel's motion to approve Mr. Fraser's document in principle was unanimously adopted.

There was some discussion as to the advisability of publishing the document, but it was decided to consider this problem after the final draft of the document had been approved and after discussing the subject with the Board.

Mr. Evans hoped that appreciation would be expressed to the Board of Governors for sending members of the Council the studies prepared in anticipation of the hearings of the Wagner Committee on the banking structure of the country.

It was decided also to discuss the Jones-Wheeler bill (H. R. 8748 and S. 3509).

The meeting adjourned at 6:15 P. M.

WALTER LICHTENSTEIN,
Secretary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

May 20, 1940

At 10:20 A. M. a preliminary joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of the Federal Reserve Building, Washington, D. C.

Present: Members of the Board of Governors of the Federal Reserve System:

Chairman Marriner S. Eccles; Governors M. S. Szymczak, John K. McKee, Chester C. Davis, and Ernest G. Draper; also Messrs. Chester Morrill, Secretary of the Board of Governors; S. R. Carpenter, Assistant Secretary of the Board of Governors; E. A. Goldenweiser, Director, Division of Research and Statistics; and C. E. Parry, Chief of the Division of Security Loans of the Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Mr. Howard A. Loeb, Vice President; Messrs. Thomas M. Steele, Leon Fraser, B. G. Huntington, C. E. Rieman, S. E. Ragland, John Crosby, John Evans, R. Ellison Harding, Paul S. Dick, and Walter Lichtenstein, Secretary

The President of the Council on behalf of the Council, its Executive Committee, and individual members offered to the Board of Governors in this time of crisis all possible aid.

The President of the Council also stated that in view of the existing confusion and uncertainty, it would be impossible for the members of the Council to make any predictions regarding business prospects in the next ninety days. It was decided to discuss at the meeting tomorrow conditions during the past thirty days rather than attempt to forecast what might happen in the next ninety.

The President of the Council thanked the Board of Governors for sending to the members the studies prepared in anticipation of the hearings to be conducted by the Wagner Committee regarding the banking structure of the country.

A discussion took place regarding the Jones-Wheeler bill (H. R. 8748 and S. 3509). It was suggested to the Council that it would be unwise at this time for the Council to take any definite position, but it might for the record file an analysis of the bill, it being understood that nothing would be published in regard to it.

The President of the Council asked whether the Board had any special problems which the Council might consider at this time.

The Chairman of the Board replied that there was no bill concerning which there was any action needed at this time, since the events of the last few weeks had relegated to the background most problems except those concerned with preparation for defense. So far none of the problems confronting the administration had come directly within the purview of the Board, especially since all questions relating to exchange, money, etc. were under the jurisdiction of the Treasury, and all the Board could do was to give advice. At the present time banks were not in need of credit, and loans being made to business were being handled by agencies other than the Board of Governors of the Federal Reserve System.

The bond market so far had behaved very well and up to date no special weakness had appeared. It was well known that the System would do its best to support the bond

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

market, and this fact in itself may have helped to prevent such weakness as had appeared to some extent in the stock and commodity markets. No change was contemplated at the moment in respect to marginal requirements, and in fact there had been no discussion.

Governor Davis left the meeting at 11:15 A. M.

Governor Draper discussed the Mead bill, and Chairman Eccles also made some confidential remarks in respect to it.

Governor McKee asked that the Council review its recommendation of November 29, 1938, relating to assignment of claims on the United States.

Governor McKee also suggested that the Council might find it advisable to make some recommendation bearing on Regulation U.

He suggested that loans might be amortized on some regular basis, leaving marginal requirements entirely to the judgment of the banker and to be based on information in the files of the bank as to the ability of the borrower to repay loans. There might have to be some limit placed as to the amount of a loan and the period of maturity. He thought that in this way a market might be created for small capital loans.

At 11:35 A. M. Governor Davis returned to the meeting.

The President of the Council stated that banks ought to have the right to take over brokers' loans, so that borrowers who were entirely solvent might not be sold out by their brokers at a time when banks would be glad to lend the money. He thought that as long as the requirements were the same for brokers and banks, there would be no harm in having transfers of loans both ways, that is, not merely from banks to brokers, but also from brokers to banks.

Dr. Parry expressed the opinion that there was not any reason at this time why some amendments might not be made in Regulation U.

Governor Davis expressed appreciation for the Council's offer to help in this emergency.

Governor Szymczak suggested that members of the Council might consider whether it would not be advisable for them to meet before their meetings in Washington not merely with the officers of their respective Federal Reserve banks, but also with the Boards of Directors of these banks.

The meeting adjourned at 12:10 P. M., and the Council had luncheon with the Chairman of the Board of Governors.

WALTER LICHTENSTEIN,
Secretary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

May 20, 1940

At 2:30 P. M. the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Howard A. Loeb, Vice President; Messrs. Thomas M. Steele, Leon Fraser, B. G. Huntington, C. E. Rieman, S. E. Ragland, John Crosby, John Evans, R. Ellison Harding, Paul S. Dick, and Walter Lichtenstein, Secretary.

On behalf of Mr. Clay, Mr. Fraser raised two questions in respect to the problem of "easy money": (1) Whether it might be advisable to have all foreign securities taken over and participating certificates issued by some type of investment trust. (2) Whether it might be desirable to freeze savings deposits at their present levels, or make reserve requirements for savings deposits identical with those for demand deposits.

It was felt by members of the Council that Mr. Clay's proposals were too controversial in character to consider at the present time.

It was voted to request the Chair to appoint a drafting committee of four members to go over Mr. Fraser's document bearing on "easy money."

The Chair appointed as a drafting committee Messrs. Fraser, Steele, Loeb, and Evans.

At 2:40 P. M., Dr. E. A. Goldenweiser, Director, Division of Research and Statistics of the Board of Governors of the Federal Reserve System, appeared before the Council and discussed the present situation.

Dr. Goldenweiser left the meeting at 3:45 P. M.

Mr. Evans moved and Mr. Fraser seconded a proposal that the Chair appoint a committee to draw up a statement dealing with the Jones-Wheeler bill (H. R. 8748 and S. 3509) to be filed with the Board of Governors to be held by it for future use.

It was unanimously voted to have such a committee, and the Chair appointed Messrs. Dick, Huntington, and Harding.

It was voted not to take any action on the Steagall bill (H. R. 8638).

It was voted not to take any action in respect to the Home Owners Loan bill.

It was voted to reiterate the recommendation dealing with assignment of claims on the United States, which was originally adopted by the Council on November 29, 1938.

The Chair agreed to draft a resolution dealing with possible amendments to Regulation U.

The meeting adjourned at 4:30 P. M.

WALTER LICHTENSTEIN,
Secretary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

May 21, 1940

At 10:10 A. M. the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Howard A. Loeb, Vice President; Messrs. Thomas M. Steele, Leon Fraser, B. G. Huntington, C. E. Rieman, S. E. Ragland, John Crosby, John Evans, R. Ellison Harding, Paul S. Dick, and Walter Lichtenstein, Secretary.

The Secretary read the draft of a resolution dealing with the Jones-Wheeler bill (H. R. 8748 and S. 3509), presented by Mr. Dick's Committee.

With a slight change in phraseology in item six, the draft was adopted as read unanimously, and is herewith incorporated in these minutes:

"JONES-WHEELER BILL

"The Federal Advisory Council has considered the pending Jones-Wheeler Bill (H. R. 8748 and S. 3509) and is opposed to the enactment of this proposal for the following reasons:

"1. It would be a serious threat to the credit structure of the nation;

"2. It would destroy the cooperative features of the Federal Land Bank system;

"3. It would substitute the guarantee of the Government for the collateral underlying the bonds of the Federal Land Bank system;

"4. It would inauguarate a new scale-down of all farm mortgage indebtedness;

"5. It would destroy the integrity of the obligations of the borrowers through the abolition of personal liability;

"6. It would make the farmers dependent upon the Government for farm mortgage credit and subject to the uncontrolled judgment of whoever might be in authority.

"The Council believes there are other vital objectionable features to the bill too numerous to be mentioned.

"The Council requests the Board of Governors of the Federal Reserve System to use its influence in the direction of preventing the passage of this bill."

The Secretary read a recommendation dealing with assignment of claims on the United States, reiterating a similar recommendation adopted November 29, 1938.

"TOPIC: Assignment of claims on the United States."

"RECOMMENDATION: The Federal Advisory Council repeats at this time the recommendation made at its meeting of November 29, 1938, and reading as follows: 'The Federal Advisory Council requests the Board of Governors of the Federal Reserve System to recommend to the proper authorites an amendment to that part of section 3477 of the Revised Statutes of the United States which is Title 31

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

U.S.C.A., Sec. 203, which makes null and void all transfers and assignments of any claims on the United States. The amendment should permit the assignment of claims where legitimate credit has been extended excepting in those cases where claims arise in consequence of torts, tax refunds, or the like.'

"The Council believes this suggested amendment to the law especially important at this time, since the Government's preparedness program whenever put into effect will result in the necessity of placing large orders for materials of all kinds. Many small and medium sized business enterprises may find it difficult to accept or execute Government orders owing to lack of capital, unless they are able to use assignments of their claims against the Government as collateral for loans."

It was unanimously voted to adopt this recommendation.

The Secretary then read a resolution dealing with Regulation U, which upon motion of Mr. Evans, seconded by Mr. Steele, was unanimously adopted. This resolution reads as follows:

"REGULATION U

"The Federal Advisory Council believes that Regulation U should be modified so as to enable a bank to loan without any requirement of initial margin for the purpose of enabling the borrower to purchase or carry listed stocks, when satisfied that the borrower has other property or income, which, apart from the collateral, reasonably assures repayment of the loan within a reasonable time.

"The Council also believes that subsection (e) of section 3 of Regulation U which now prevents a bank taking over from a broker a loan which has an impaired margin, while allowing a loan with an impaired margin to be taken over from another bank, has lost its original justification, and that subsection (e) of section 3 should be amended by adding the words "or broker" after the word "bank" in the first line.

"The Council believes such amendment to subsection (e) particularly desirable in view of present circumstances which have caused many customers' accounts with brokers to become impaired, and believes it would avoid a certain amount of enforced liquidation of listed securities whose owners are entitled to bank credit."

The Secretary thereupon read the answer to the question propounded by the Board of Governors dealing with the problem of "easy money." Some slight changes in phraseology were suggested, and it was thereupon moved by Mr. Loeb, seconded by Mr. Evans, to adopt the draft as submitted by Mr. Fraser's Committee. The motion was unanimously carried. This document is attached to and made a part of these minutes.

It was decided that in view of the great interest shown in the subject and Dr. Goldenweiser's article in the current issue of the *Federal Reserve Bulletin,* the Council would suggest that the Board of Governors have the Council's reply to the Board's question published in a forthcoming issue of the *Federal Reserve Bulletin.*

The meeting adjourned at 11:30 A. M.

WALTER LICHTENSTEIN,
Secretary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

May 21, 1940

At 11:25 A. M. a joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of the Federal Reserve Building, Washington, D. C.

Present: Members of the Board of Governors of the Federal Reserve System:

Chairman Marriner S. Eccles; Governors M. S. Szymczak, John K. McKee, Chester C. Davis, and Ernest G. Draper; also Messrs. Lawrence Clayton, Assistant to the Chairman of the Board of Governors; Elliott Thurston, Special Assistant to the Chairman; Chester Morrill, Secretary of the Board of Governors; L. P. Bethea and S. R. Carpenter, Assistant Secretaries of the Board of Governors; Walter Wyatt, General Counsel of the Board of Governors; J. P. Dreibelbis, Assistant General Counsel of the Board of Governors; L. H. Paulger, Chief, Division of Examinations; E. A. Goldenweiser, Director, Division of Research and Statistics; E. L. Smead, Chief, Division of Bank Operations; and Carl E. Parry, Chief, Division of Security Loans.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Mr. Howard A. Loeb, Vice President; Messrs. Thomas M. Steele, Leon Fraser, B. G. Huntington, C. E. Rieman, S. E. Ragland, John Crosby, John Evans, R. Ellison Harding, Paul S. Dick, and Walter Lichtenstein, Secretary

The Secretary of the Council read the recommendation dealing with the assignment of claims on the United States.

Governor McKee suggested an amendment, and the Council agreed to take his suggestion under advisement when it met alone after the adjournment of the joint meeting.

The Secretary read the resolution dealing with the Jones-Wheeler bill (H. R. 8748 and S. 3509), which appears above in these minutes.

The Secretary read the resolution on amendment to Regulation U.

The President of the Council stated that it was felt that this was not an opportune time to recommend the complete repeal of Regulation U, though it was felt that this should ultimately be done. However, there was no reason why an amendment to Section (e) of Section 3 could not be adopted immediately.

Dr. Parry stated that he thought brokers should be allowed to take over accounts from banks, but there might be some difficulty, because under the law, brokers are not allowed to lend on unregistered securities. He stated that there might be some problems due to insufficient margins involving a bank's position, though he did not regard this matter of importance. Amendments might make the administration of both Regulations T and U more complicated, and changes in Regulation T would have to be cleared with the Securities and Exchange Commission.

Before asking the Secretary of the Council to read the reply prepared by the Council to the Board's question on "easy money" policy, the President of the Council stated that in view of the public interest in this question and Dr. Goldenweiser's article in the May

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

issue of the *Federal Reserve Bulletin*, the Council thought it might be desirable to have its answer published in an early issue of the *Federal Reserve Bulletin*. Furthermore, unless the Board of Governors had some objection, the members of the Council would very much like to have the answers made by the several Federal Reserve banks to the same question.

The Secretary of the Council thereupon read the Council's reply to the Board's question relating to the "easy money" policy.

The President of the Council stated that obviously it was not desirable to have any publication at this moment, but at an opportune time the whole question should be brought up publicly. The members of the Council are entirely open minded as regards the matter of timing.

The Chairman of the Board of Governors stated that publication in the *Bulletin* would require an answer by the Board, and this would arouse controversy. It was, after all, a technical question, and he felt that very little good would result from a public discussion at this time.

A long discussion took place in regard to the answer of the Council.

At 12:40 P. M. Mr. Harding left the meeting and at 12:45 P. M. Governor McKee left the meeting.

The Chairman of the Board of Governors gave a history of the whole subject of "easy money" policy. At the end, the President of the Council stated again that the Council had no desire to engage in a public controversy, that it would leave it entirely to the judgment of the Board as to when and how it desired to publish the Council's reply to its question.

The meeting adjourned at 1:45 P. M.

WALTER LICHTENSTEIN,
Secretary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

May 21, 1940

At 1:50 P. M. the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Howard A. Loeb, Vice President; Messrs. Thomas M. Steele, Leon Fraser, B. G. Huntington, S. E. Ragland, John Crosby, John Evans, Paul S. Dick, and Walter Lichtenstein, Secretary.

It was unanimously voted to adopt the changes in the recommendation on assignment of claims as suggested by Governor McKee, and the revised recommendation as finally adopted is attached to and made a part of these minutes.

After a discussion regarding the desirability of publishing the Council's reply to the Board's inquiry dealing with the "easy money" policy, the Secretary of the Council was instructed to convey to the Secretary of the Board the views of the Council as follows:

> "On May 21, 1940, the Federal Advisory Council requested the publication in the forthcoming issue of the *Federal Reserve Bulletin* of its answer to the question on 'easy money' propounded by the Board of Governors of the Federal Reserve System.
>
> "In deference, however, to the views of the Board, the Council withdraws this suggestion and will reconsider the question of publication at the September meeting by which time it hopes to have from the Board any comments on the Council's answer the Board may desire to make. If the Board should desire to publish the Council's answer prior to the September meeting, the Council has no objection thereto."

The Secretary raised the question what to do about possible requests of Federal Reserve banks for copies of the Council's reply on the matter of the "easy money" policy. While no formal action was taken, it was the sense of the meeting that it would be undesirable for any member of the Council to do more than give one copy of the document to the President of his Federal Reserve bank.

The meeting adjourned at 2:15 P. M.

WALTER LICHTENSTEIN,
Secretary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

RECOMMENDATION OF THE FEDERAL ADVISORY COUNCIL TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

May 21, 1940

TOPIC No. 1. Assignment of claims on the United States.

RECOMMENDATION: The Federal Advisory Council repeats at this time the recommendation made at its meeting of November 29, 1938, and reading as follows: "The Federal Advisory Council requests the Board of Governors of the Federal Reserve System to recommend to the proper authorities an amendment to that part of section 3477 of the Revised Statutes of the United States which is Title 31 U.S.C.A., Sec. 203, which makes null and void all transfers and assignments of any claims on the United States. The amendment should permit the assignment of claims where legitimate credit has been extended excepting in those cases where claims arise in consequence of torts, tax refunds, or the like."

The Council believes this suggested amendment to the law especially important at this time, since the Government's preparedness program whenever put into effect will result in the necessity of placing large orders for materials of all kinds. Many small and medium sized business enterprises would be in a better position to accept and execute Government orders if they were able to use assignments of their claims against the Government as collateral for loans.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STRICTLY CONFIDENTIAL

FEDERAL ADVISORY COUNCIL

May 20, 1940

Under date of April 27, 1940, the Federal Reserve Board, through its Secretary, asked the following

QUESTION

> "The Council has urged upon the Board the 'modification of the policy of extreme easy money'. The Board would like to have the opinion of the Council as to the more important causes of the 'easy money' conditions; as to what actions within the power of the Board of Governors would be desirable and effective in the public interest; and as to the probable consequences of such actions."

ANSWER

I - Causes

In the unanimous opinion of the Council, the more important causes of extreme "easy money" are:

1. The adoption by the Federal Reserve Board of "easy money" as a guiding policy, and its continuous advocacy in annual reports, other publications, at Congressional hearings, in advice to the Executive, and in public addresses and press interviews. The Board should not underestimate the influence it has exercised, or the responsibility it has assumed before the public, the Congress, and other governmental agencies, by repeatedly defining "easy money" as the official monetary objective of the highest responsible monetary authority in the land. The following quotation from its 1939 report to the Congress is one of many which define that objective.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"In recent years it has been the policy of the Government and of the Federal Reserve System to encourage the expansion of credit. This has constituted the so-called policy of monetary ease, which has been directed at keeping banks supplied with an abundant volume of reserves, so as to encourage them to expand their loans and investments. This policy has been one of the factors in the creation of the existing large volume of deposits in the hands of business enterprises and of individual and corporate investors, and has resulted in reducing interest rates to the lowest level in history.****

"Nor is there any immediate reason for considering a reversal of this policy." (Report submitted January 27, 1939)

As far as the Council is aware, the Board still advocates the doctrine of "easy money" and is taking no steps to set up warning signals against the evil effects of the extreme to which it has been carried and of the dangers of its continuance, nor to evolve any long range plans to eliminate some of its causes or to counteract its consequences. The Council believes that this policy has failed after years of trial to bring about its pre-announced objectives--namely the expansion of private borrowing, the stimulation of business and the reduction of unemployment and that the dangers of the extreme to which it has been carried are now so apparent that the Board should publicly advocate its modification.

2. The expansive open market operations of the System beginning toward the end of 1929, continuing for several years, and never reversed in principle. (Note Annual Report of the Board dated June 18, 1937.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

3. The too long delayed reduction of the portfolio of Government bills thereby forcing interest rates on bills to the vanishing point. The repetition of that process in the case of the Government bonds acquired last autumn and retained (except for some relatively small sales) in the face of a market that rose steadily until a few days ago--despite the fact that so great a volume was not needed for the maintenance of the System. As hitherto stated, when repeatedly advising sales, the Council is of the opinion that it was and is unhealthy for the central monetary authority to retain as a fixed policy a large volume of Government obligations.

4. The unprecedented spending program of the Federal Government, which necessitated borrowing and inevitably induced the authorities to exercise their influence in the direction of keeping interest rates at a minimum. Deficit financing and official pressure for "easy money" go hand in hand. Furthermore, to the extent that the Government has borrowed from commercial banks, and dispersed the funds, an increase in the aggregate of deposits has resulted, intensifying the pressure upon interest rates.

5. A series of other policies of the Federal Government tending to increase the supply of funds or the volume of excess reserves, or both, such as:

(a) The increase in the dollar price of gold, thereby encouraging the production of that metal;

(b) The discontinuance of the practice of sterilizing incoming gold;

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(c) The policy of purchasing silver far above its world price and issuing silver certificates therefor on the basis of the artificial valuation;

(d) The creation of scores of lending agencies which, avowedly established for emergency purposes, are apparently perpetuating themselves, and are lending taxpayers' funds at progressively lower rates, often in competition with the taxpayer himself;

(e) The Johnson Act and the "cash-and-carry" provisions of the neutrality laws upon the merits of which the Council does not express an opinion but which, in effect, are impelling most of the leading foreign powers to ship us gold or to go without indispensable supplies.

6. The series of policies of the Federal Government tending to decrease the demand for funds on the part of business enterprise. The Council has no wish to appear to enter into the field of political controversy, and therefore contents itself with stating, purely objectively, that it is its belief that the concept of more and more state interventionism, expounded by many Government officials as a universal remedy, and the growing practice of it, have exercised and are exercising a depressant effect upon new capital demand in many fields, with the result that even at the prevailing low money rates, relatively little new industrial borrowing for other than refunding purposes has taken place.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(7) The developments abroad that have led to the repatriation of American capital and have caused huge shipments of gold to this country by foreigners,--both operations that have vastly contributed to our excess reserves, thereby affecting the interest rate structure. The Council believes that we should continue to accept incoming gold, but notes that no steps are being taken to attempt to offset this influence upon our credit structure.

The Council has mentioned this important cause last, not because it does not recognize its dominant influence, but because it feels that this cause should not be permitted to overshadow the many other important causes, enumerated above, or to create any misconception that "easy money" has been thrust upon the responsible monetary authorities against their wills.

II - Action to Be Taken

In the opinion of the Council, there is no more important public service which the Board and its members can perform than to use their influence in every direction possible to bring an end to the period of extreme "easy money". Among the steps to that end that might be taken are:

1. Let the Board publicly announce that in the light of events, it is modifying its former policy of extreme "easy money" and will exercise its powers, particularly those of counsel and persuasion, to reverse the trend. This does not mean credit stringency or high interest rates,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

but means only a recognition of the fact that extremely "easy money" is reducing the purchasing power of millions of American citizens, and is creating hardship without compensating advantage in stimulating business or reducing unemployment.

2. Reduce the Government portfolio at the earliest opportunity and adhere consistently to the policy of purchasing Governments only to offset manifestly disorderly or panicky markets and to dispose of such purchases as soon as circumstances permit.

3. Exert the Board's influence with the Treasury, directly and through the Open Market Committee, against the choice of methods of Government financing which would tend to make money rates still lower or to increase excess reserves by the use, for example, of silver seigniorage "profits" or similar "funds" to avoid the debt limit. Indeed there should be public opposition to all such devices that can but create more excess reserves and more extreme low rates.

4. Exert its influence upon the Treasury toward the establishment of a policy in offering Government securities which would encourage their purchase as far as possible by investors--such as individuals, life insurance companies, trusts, etc.--rather than by the commercial banking system.

5. Accept the role customarily exercised by the central monetary authority of "keeper of the Government's financial conscience", and in that capacity actively and openly insist upon the elimination of the several menaces to the financial structure, many of which, among

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

other things, would still further increase excess reserves, such as the power to issue greenbacks, further to devalue the dollar, etc.

6. Consider plans, on a long range basis, which may at the proper time be recommended for the purpose of coping with the gold and silver problems, such as the question of reestablishing a full gold standard with the resumption of specie payment, readopting sterilization (any such sterilized gold to be released only with the approval of the Open Market Committee), reconsidering the silver program, alteration of the legal reserve requirements, and use of existing legal powers in these respects. With reference to the adoption of any of the foregoing measures the Council recognizes that the prevalence of war conditions may make the matter of timing one of extreme importance.

7. If the Board is unprepared to take any or all of the foregoing steps, we urge that it enter upon the study of the probable long range consequences of the extreme "easy money" policy, which the Council recommended to the Board in February of last year, when it expressed the belief that the probable fundamental consequences of this policy had not been fully appreciated. The Board then replied, in effect, that it considered that such a special independent study was not required. The Council cannot share this view. Last June it detailed what, in its judgment, had been some of the evil consequences of extreme "easy money", and expressed the opinion that present tendencies contained grave threats for the future. It is unnecessary to repeat this lengthy resolution here. No answer has been received by the Council, and the Council is

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

still unaware as to how far, if at all, the Board shares its views. Such a study is clearly within the power of the Board and the Council believes that it is highly desirable in the public interest.

It seems to the Council that the Board should make the difficult effort of projecting itself five to ten years into the future and reach conjectures, assuming a continuation of the present extreme "easy money" conditions, as to the then probable economic results. For example:

1. What will be the condition of the commercial banks?

2. What will have happened to the mutual savings banks and to the principal and interest of the millions who have entrusted their hard-earned savings to the care of such institutions?

3. What will have happened to the cost of life insurance and the return therefrom, and to the income received, or to be received, by the beneficiaries of the sixty million persons who are paying for life insurance or annuities?

4. What will be the aggregate debt burden of Federal and local governments?

5. What will be the position of the operations, and staff of our great private and semi-public hospital, educational, religious, and charitable institutions throughout the land, dependent in large measure upon income from the generous endowments that private enterprise has contributed in the past?

6. What will have happened to the purchasing power of the army of the hard-working and thrifty who have set something aside for

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

their old age or a rainy day?

7. What will be the effect on additional unemployment, arising out of the inability of persons whose incomes from investments are reduced, to continue their usual purchases of goods and services? Is not this whole class being subjected to a veiled form of taxation if the rates of interest are artificially forced, say one per cent, below what would otherwise be operative?

8. What are the probable advantages to offset the imperilment of our commercial banks, our savings banks, our assurance funds, our endowment funds, and the hardship to those who live on their savings, to widows and children of those deceased?

This enumeration of questions is merely illustrative of many more.

III - Consequences

The Council believes that in the long run the consequences of action in the direction of a reversal of the policy of extreme "easy money" would be beneficial to our economy and would help toward a partial restoration of confidence in the future of private enterprise, which is the condition precedent to sustained recovery and which represents the only alternative to state socialism or worse. The Council believes that the Board might take a leaf from the book of British experience since the beginning of the depression. While believing in, and practicing, a policy of "easy money", the British authorities were careful to avoid the pitfall of extreme "easy money", because they

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

recognized that "easy money" is a destructive influence if pushed too far. Thus, for example, the authorities collaborated with the market in preventing the ninety day bill rate from falling below one half of one per cent. What relation this sounder administration of the policy of "easy money" had to the British recovery, which was much more rapid and complete than here, is a matter of opinion, but its objective of protecting the banking system, and investment generally, is manifest. The Council maintains no argument for high interest rates, as such. Indeed, in an atmosphere of confidence and given sound underlying conditions, low interest rates often have a beneficial effect upon business and the economy generally. But abnormally low interest rates, due in part to the persistent efforts of Government interventionism, create uncertainty and have a depressing effect upon the economic structure. They are certainly not a natural accompaniment of a situation where enormous Government deficits are piling up and more are frankly predicted, where taxes are steadily mounting, accumulated wealth steadily being consumed, and business confidence fundamentally lacking.

In expressing the view that the consequences of a change of trend would be of a beneficial character, the Council recognizes that existing complexities of the economic and political situation are such that confident prediction as to the consequences of any single remedial step is hardly warranted. The failure of prices to respond, except fleetingly, to the change in the gold content of the dollar, the breakdown of the "pump priming" experiment, the failure of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the policy of stimulating spending by taxing undistributed earnings, the failure of the "easy money" policy as a stimulant to new private borrowing, are all illustrations of the dangers of definite prediction in a world where the normal operations of economic laws are frustrated by one artificial device after another. It cannot be expected, therefore, that damage done by a single policy will be instantly remedied by a modification of that policy alone, but the Council does believe that a change in the policy is necessary before a sound economic structure can be restored, and that in the long run the Board will have rendered great service to the country by modifying publicly, definitely, and actively its previous policy, by taking all steps within its power to correct the situation, including therein the potent ones of advice, warning, and popular education, and to oppose all measures of our Government, the natural consequences of which are to maintain extreme "easy money", or to drive rates still lower.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis