MINUTES OF MEETING
of the
FEDERAL ADVISORY COUNCIL
May 17-18, 1942
and of the
MONTHLY MEETINGS
of the
EXECUTIVE COMMITTEE
April 9, 1942
June 3, 1942

# MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

May 17, 1942

The second statutory meeting of the Federal Advisory Council for 1942 was convened in Room 936 of the Mayflower Hotel, Washington, D. C., on Sunday May 17, 1942, at 2:00 P.M., the President, Mr. Brown, in the chair.

Present:

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| Mr. Charles E. Spencer, Jr. | District No. 1 |
| Mr. George L. Harrison | District No. 2 |
| Mr. William Fulton Kurtz | District No. 3 |
| Mr. B. G. Huntington | District No. 4 |
| Mr. Robert V. Fleming | District No. 5 |
| Mr. H. Lane Young | District No. 6 |
| Mr. Edward E. Brown | District No. 7 |
| Mr. S. E. Ragland | District No. 8 |
| Mr. Lyman E. Wakefield | District No. 9 |
| Mr. W. Dale Clark | District No. 10 |
| Mr. Nathan Adams | District No. 11 |
| Mr. George M. Wallace | District No. 12 |
| Mr. Walter Lichtenstein | Secretary |

On motion, duly made and seconded, the minutes of the Council meeting of February 15-16, 1942, copies of which have been previously sent to the members were approved.

The President reviewed the situation in connection with prospective government financing and discussed the 20-25 year redeemable issue at 2½%, of which about $800 million had been sold.

There was also a discussion regarding reserve requirements, especially in respect to the New York situation.

In a discussion concerning E, F, and G bonds, opposition was expressed by all members of the Council to any scheme of compulsory saving.

The President summed up the views of the members of the Council as shown by the discussion:

1. Compulsory savings should not be tried except as a last resort and all possible pressure should be applied to induce people to buy bonds voluntarily.
2. No new forms of redeemable bonds should be issued. The majority of the Council believes that the limit of permissible subscriptions in a year to F and G bonds should be raised from $50,000 to $100,000.
3. No fixed scheme of financing should be adopted and announced, though some members believe that there should be an announcement that there would be available for insurance companies and similar corporations, long-term issues put out at reasonable intervals and, likewise, short-term issues for banks.

In a further discussion of the reserve situation, it was found that all members of the Council are opposed to any reduction of reserve requirements at this time.

A short discussion of the difficulties caused by Regulation W took place, and it was agreed that the Board of Governors should be told that the recent amendment to the

Regulation seems undesirable to members of the Council, as it causes needless irritation, is expensive to administrate, and makes for bad relationship between banks and their customers, without at the same time accomplishing anything of importance.

A discussion regarding Regulation V took place, and Mr. Kurtz pointed out that in recent war contracts the clause had been omitted which protects banks against future claims by the government. It was agreed that the attention of the Board of Governors should be called to this matter.

The meeting adjourned at 5:30 P. M.

WALTER LICHTENSTEIN,
Secretary.

# MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

May 18, 1942

At 9:30 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. George L. Harrison, Vice President; Messrs. Charles E. Spencer, Jr., William Fulton Kurtz, B. G. Huntington, H. Lane Young, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, Nathan Adams, George M. Wallace, and Walter Lichtenstein, Secretary.

The President of the Council reviewed the conclusions reached yesterday.

The meeting adjourned at 10:00 A. M.

WALTER LICHTENSTEIN,
Secretary.

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

May 18, 1942

At 10:35 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; Vice Chairman Ronald Ransom; Governors M. S. Szymczak, John K. McKee, Ernest G. Draper, and Rudolph C. Evans; also Messrs. Lawrence Clayton, Assistant to the Chairman; Chester Morrill, Secretary of the Board of Governors; Liston P. Bethea and S. R. Carpenter, Assistant Secretaries of the Board of Governors; Walter Wyatt, General Counsel; E. A. Goldenweiser, Director, Division of Research and Statistics; Edward 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. George L. Harrison, Vice President; Messrs. Charles E. Spencer, Jr., William Fulton Kurtz, B. G. Huntington, Robert V. Fleming, H. Lane Young, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, Nathan Adams, George M. Wallace, and Walter Lichtenstein, Secretary.

The President of the Council stated that the Council did not have any resolutions or recommendations to present, but wished to discuss a number of matters.

In the first place, the President pointed out that the members of the Council believed that compulsory saving should be resorted to only after every other means of obtaining sufficient subscriptions to E, F, and G bonds had failed. A lengthy discussion took place between members of the Council and members of the Board of Governors.

The President of the Council stated that the members of the Council do not favor new types of redeemable bonds. The majority of the members of the Council would like to see the limit of permissible annual subscriptions to F and G bonds raised to $100,000. Furthermore, the members of the Council do not regard it as feasible for the Treasury to announce, at this time, details of further financing.

The Chairman of the Board stated that the Board is in disagreement with the view expressed by the Council and is so on record. He also suggested a five year bond, redeemable on notice after six months, with graduated interest rates, depending on the length of time the security is held. He stated that the Treasury would thus be relieved of the necessity of selling a new issue every six months or every year.

A discussion took place regarding the reserve situation.

The Chairman of the Board suggested that changes in reserve requirements in banks located in New York and Chicago should not be dependent on changes made in reserve requirements for banks located in reserve cities. The Chairman of the Board also stated that a change would be proposed in the Banking Act, permitting a deficiency in the daily required reserves of banks, provided the average of reserves for the weekly period did not show any deficiency.

In respect to Regulation W, the President of the Council pointed out that in the opinion of the members of the Council, the amendment to the Regulation pertaining to loans of $1500 and under made by banks, was not satisfactory. However, the Council at this time did not wish to enter into a detailed discussion.

A discussion was begun in respect to regulation V.

The meeting adjourned for lunch at 1:15 P. M.

WALTER LICHTENSTEIN,
Secretary.

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

May; 18, 1942

At 2:30 P. M., the joint conference of the Federal Advisory Council and the Board of Governors reconvened 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; Vice Chairman Ronald Ransom; Governors M. S. Szymczak, John K. McKee, Ernest G. Draper, and Rudolph C. Evans; also Messrs. Lawrence Clayton, Assistant to the Chairman; Chester Morrill, Secretary of the Board of Governors; Liston P. Bethea and S. R. Carpenter, Assistant Secretaries of the Board of Governors; Walter Wyatt, General Counsel; George V. Vest, Assistant General Counsel; E. A. Goldenweiser, Director, Division of Research and Statistics; Edward L. Smead, Chief, Division of Bank Operations; Carl E. Parry, Chief Division of Security Loans, and Kenton R. Cravens.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Mr. George L. Harrison, Vice President; Messrs. Charles E. Spencer, Jr., William Fulton Kurtz, B. G. Huntington, H. Lane Young, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, Nathan Adams, George M. Wallace, and Walter Lichtenstein, Secretary.

Continuing the discussion of Regulation V, the President of the Council discussed the assignability of contracts. The Chairman of the Board asked that the facts which the President of the Council had discussed be presented in the form of a letter to the Board. A copy of such a letter is attached hereto and made a part of these minutes.

The meeting adjourned at 4:00 P. M.

WALTER LICHTENSTEIN,
Secretary.

May 18, 1942

At 4:05 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. George L. Harrison, Vice President; Messrs. Charles E. Spencer, Jr., William Fulton Kurtz, B. G. Huntington, H. Lane Young, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, Nathan Adams, George M. Wallace, and Walter Lichtenstein, Secretary.

A discussion regarding the proposal of the Chairman of the Board of Governors, advocating a special type of short term issue, took place.

Acting in accordance with the instructions of the President of the Council, the Secretary of the Council subsequently transmitted to the Secretary of the Board of Governors the results of this discussion of the members of the Council. A copy of the Secretary's letter is appended hereto and made a part of these minutes.

Messrs. Clark, Adams, and Wallace left the meeting at 4:25 P. M.

At 4:30 P. M., Dr. Goldenweiser appeared before the Council and discussed the question of the reserve situation in New York and its effect on money rates, as well as general business conditions.

The meeting adjourned at 5:20 P. M.

WALTER LICHTENSTEIN,
Secretary.

New York, N. Y.
May 20, 1942

Dear Mr. Morrill:

As you will recall, on May 18, at the joint meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council, held in the Board Room of the Federal Reserve Building, it was agreed that the Federal Advisory Council would submit to the Board of Governors data in regard to a certain situation which has arisen in regard to bank advances against assignment of claims arising out of contracts let by the Army and Navy Departments and the United States Maritime Commission.

In accordance with this understanding, I have been instructed to request you to submit the following to the Board of Governors of the Federal Reserve System, and the Council bespeaks the good offices of the Board to bring about a remedy of the situation that has arisen.

The Assignment of Claims Act of October 9, 1940, contains a provision reading, "(c) Payments to an assignee of any claims arising under this contract shall not be subject to reduction or set-off for any indebtedness of the contractor to the United States arising independently of this contract."

This provision was obviously necessary to safeguard the lender; first, against any claims or contracts other than those against which the advance had been made, and, secondly, against possible tax claims of the Internal Revenue Department. Banks have generally understood that this "set-off" clause was a standard part of all war contracts, and we have been informed by the legal staff of the Navy Department that all its contracts contain the clause.

During the month of April, however, a Philadelphia bank received letters from the General Accounting Office in Washington, disclaiming assignments on two different contracts (one, Quartermaster Corps, the other, Maritime Commission) and stating that neither original contract contained this "set-off" clause. The contractor and the bank were asked to agree to the deletion of the clause in the assignment, which would then be recorded and returned. It was further suggested that in the future, at the time of making the advance, it should ascertain from the contracting officer whether or not the "set-off" clause was to be in the contract to be financed. From a practical operating point of view, such a requirement would greatly hamper the financing of war production because in actual practice the banks are advancing funds on "Letters of Intent or Award," and the contract is not often completed and available for several weeks afterward. There are instances where the goods under contract have been actually manufactured and shipped before the formal contracts have been executed.

The "set-off" clause is both necessary and equitable and the Act so recognizes. It would seem, therefore, that it should be included as a standard clause in all war contracts. If it is not, and the lending bank must await the execution and inspection of each contract, there may result unnecessary and unfortunate delays in the production of vital war material.

It is suggested that the Federal Reserve authorities and the Comptroller's Office might both be interested in this situation which involves enormous advances on the part of the banks under their supervision.

Very truly yours,

(Signed) WALTER LICHTENSTEIN,
Secretary.

Mr. Chester Morrill,
Secretary, Board of Governors of the
Federal Reserve System,
Washington, D. C.

New York, N. Y.
May 20, 1942

Dear Mr. Morrill:

Confirming our telephone conversation of yesterday and my conversation with Miss Dodd in reference to the attitude of the Council toward the type of bond issue suggested by the Chairman, namely, a redeemable bond issue with a maturity of five years, payable on demand after being held six months, and with a graduated rate of interest, the rate depending on the length of time the bond is held, I have been instructed by the President of the Council to give you the following further information:

The subject was carefully discussed by the members of the Council with the following result: six of the members of the Council are opposed to an issue of this type on principle; four members of the Council are opposed to such an issue at this time, while one member of the Council is in favor of such an issue. One member of the Council was not present at the session at which this topic was discussed.

Very truly yours,

(Signed) WALTER LICHTENSTEIN,
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Very truly yours,

(Signed) Walter Lichtenstein

Secretary.

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Secretary Board of Governors of the
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It is suggested that the Federal Reserve authorities and the Comptroller's Office might both be interested in this situation which involves enormous advances on the part of the banks under their supervision.

Very truly yours,

(Signed) Walter Lichtenstein
Secretary

Mr. Chester Morrill,
Secretary, Board of Governors of the
Federal Reserve System
Washington, D. C.

NOTE: The transcript of the Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript should be considered as being strictly for the sole use of the members of the Federal Advisory Council.

W. L.

Secretary's notes on meeting of the Federal Advisory Council on May 17, 1942, at 2 p. m. in room 936 of the Mayflower Hotel, Washington, D. C.

The minutes of the Council meeting of February 15-16 and of the monthly meeting of the Executive Committee of March 12, 1942, were approved.

PATTERN OF WAR FINANCING

Brown tells that Morgenthau fought against compulsory savings, and after some delay, the President overruled Henderson and others. It was agreed that for the present, voluntary savings should be tried. The Board of Governors suggested two redeemable tap issues: (a) A five-year issue at 1 1/3%, (b) A 20-25 year issue at 2 1/2%. What was actually put out was a redeemable issue at 2 1/2%. $800 million were subscribed, the bulk of the subscriptions coming from insurance companies. The insurance companies were using cash that had accumulated in recent years, owing to difficulty of finding suitable investment for it, so that in a sense, magnitude of the taking was due to non-recurring accumulation of cash.

Kurtz believes there ought to be issues for banks at such intervals that banks can stagger their holdings properly.

Harrison says the Treasury is not in a position to state in detail at this time what its plans may be.

Wakefield agrees that the Treasury is not in a position to give advance information. He points out that the banks are, after all, now under complete government control.

Spencer says that the machine tool industry is slowing down. He ascribes this to the fact that there has been a very large piling up of material manufactured under the Lease-Lend arrangements and that much of this material cannot be shipped at the present time.

Wakefield believes bank loans are going to decrease while, at the same time, expenses are increasing. Consequently, all that is left for the banks to do is to buy bonds, and he believes that the banks will have to buy long-term bonds in order to make expenses. As deposits increase, funds must be employed in order to meet the F. D. I. C. charge of 1/12% on deposits. He believes reserve requirements will be cut.

Brown says the reserve situation has been the subject of much discussion between the Treasury and the Federal Reserve Board. New York City was down to $406 million, but is now back to $650 million. Treasury, which has been [illegible] having New York City banks take about 40 to 60 per cent of issues, has become alarmed. This has given rise to the suggestion that reserve requirements all over the country be reduced but the Board is opposed to this. An alternative suggestion has been to reclassify reserve cities and make New York and Chicago reserve cities and thus reduce their present requirements of 26 per cent to 20 per cent. Another suggestion has been to limit reserve cities to those places where a Federal Reserve bank or a branch thereof is located. This does not seem feasible. Brown believes that, owing to the cessation of foreign trade, the falling off of the influx of gold, and the almost complete disappearance of new security issues, it is natural that money has flowed out of the New York banks and, in his opinion, the Treasury must expect to sell bonds where money is being spent, which is mostly outside of New York. New York banks have become more dependent upon War Loan Deposit accounts. The Federal Reserve Board is opposed to reclassifying New York and Chicago as reserve cities in part because the Federal Reserve Act definitely provides for three classes of banks. However, the Treasury is very anxious to have the Federal Reserve System do something to relieve the New York situation.

Harrison says the Open Market Committee has been buying bills from New York banks whenever help has been needed by any bank. The Federal Reserve banks are buying June bills at the fixed rate of 3/ 8%.

Brown believes that the sooner the Treasury and the New York banks realize that bonds must be sold where the money is, the better it will be. Selling campaigns should be based on the situation as it actually exists.

Kurtz says that there are many centers outside of the largest cities where excess reserves are increasing rapidly and banks in these places have not been accustomed or trained to buy short-term bills at 3/8%.

Brown says higher rates alone will not accomplish the purpose desired.

Young says that some of the smaller banks in his region are beginning to buy short-term government obligations. He believes the education of the smaller banks has actually begun.

Brown says the chances are the small banks and the industries will buy in such quantities that bank deposits will decrease.

Wakefield says that in country banks loans are running off and there isn't any chance to make expenses, except by buying government obligations. There is some fear that there will be obligatory allotments and rather than being forced, the country banks will begin to buy.

Spencer points to the fact that in his district, mutual savings banks will buy, and in view of the State tax in Massachusetts, a 3/8% bill rate is equivalent to 1/2%.

Fleming believes that every means should be used to sell bonds to the public and thus avoid enforced savings. He doesn't see how the Treasury can make definite plans at this time. In course of time the situation may change and there may come a period when safety will be more important than marketability. He thinks there ought to be some issues salable only between banks and rediscountable at the Federal Reserve banks. He doesn't believe that the public at present would take a market issue readily, as affairs are too uncertain.

Young agrees on the whole with Fleming. He says the last issue of 2's was pretty satisfactory. He does not believe in further new redeemable issues to be bought by banks.

Ragland believes in voluntary effort but doubts whether the scheme will work. Bonds ought not to be redeemable as this may produce a very dangerous situation for the Treasury.

Fleming says that if you have enforced savings the redeemable feature will, of course, disappear.

Brown says that his understanding is that the Federal Reserve System wants the limit on purchases of redeemable bonds removed.

Wallace is opposed to compulsory savings. He thinks there ought to be an active campaign for voluntary purchases. He believes in the E, F, and G bonds but would like to see the limit in the case of the F and G bonds raised to $100,000. He does not see how the Treasury can announce any plans in advance.

Kurtz also believes in the E, F, and G bonds and would like to see the limit of F and G bonds raised. He points out the trust officers would like to buy more and more of the F and G bonds. He states that the sale of defense bonds in his bank has been in excess of ten per cent of its total deposits. He would like to stop all talk about enforced savings and on the other hand have a very stiff sales tax. When he spoke about pattern of war financing, he did not mean to imply that he would want to have the Treasury issue detailed specifications, but he did think that the Treasury might announce that there would be obligations made available to banks running from one to ten years and staggered in such a way that banks would be able to have a proper distribution in their bond portfolios. He agreed that the 2% was a good issue. He does not want redeemable bonds for banks but would like to see some sort of limited negotiability.

Harrison believes voluntary purchasing should be maintained. He does not think we shall have compulsory sales but we may have a payroll deduction tax. He is opposed to redeemable issues. If you have too many redeemable issues, there will be great difficulty after the war. After the war, if the Treasury is faced with a huge demand liability, we may have one of three things happen: (a) compulsory conversion such as took place in Great Britain at the end of the last war, (b) payment of bonds by the Federal Reserve Banks, or (c) worst of all, "greenbacks." He agrees that the limit for F and G bonds should be raised to $100,000, but he would limit the total amount of redeemable bonds to be issued in any one year to $12 billion. He would like to see the limit of F and G bonds raised in part, so that the quota of $12 billion a year could be filled by a larger sale of F and G bonds, and thus take away the argument for compulsory savings. Harrison agrees with Kurtz that it would be desirable for the Treasury to announce some broad plan. Treasury should limit banks to bonds with ten-year maturities and have issues of varying maturities available to meet all needs and tastes. Thus, for example, insurance companies would be helped if they knew there were to be more long-term issues available this year. He believes in a sales tax.

Adams believes in a sales tax and points out that enforced savings would destroy the morale of the workers.

Harrison points out that the demand for larger excess reserves and demand for higher bill rates are contradictory demands. If excess reserves increase largely, the money market becomes soft and thus there is no need for a higher bill rate.

Clark wants voluntary subscriptions. He does not like redeemable bonds and wants financing to be done as far as possible according to an orthodox pattern.

Huntington believes in voluntary as opposed to compulsory savings. He is opposed to an increase of the demand liability to which the Treasury may be subject. He does not agree that the bill rate structure can be maintained, even if the Treasury makes every attempt to do so. He believes in the sales tax very much.

Adams says that according to information he has, 22 1/2% of all redeemable bonds sold have already been redeemed.

Spencer thinks we must go along with the E, F, and G bonds. He was opposed to raising the limit, but has been converted by Harrison's arguments. He believes in the sales tax rather than in compulsory saving. He thinks the Treasury cannot announce in detail any plans, but a pattern might well be evolved.

Wakefield does not see how a pattern of government finance can be discussed in a vacuum. He believes that the government soon will undertake complete rationing and people will be able to use their money for nothing except the purchase of government obligations. This will have a great deal to do with the sale of government bonds. We have in progress a plan for credit control so that money can be lent only in accordance with government permission. Then there is the tax bill. It is probable that taxes will absorb all funds up to a point where it will be necessary to stop, unless all initiative in industry is to be killed. The proposed reduction of the exemptions under the income tax point that way. The President has announced that two billion dollars more will be taken for social security, which is simply a tax on all wages, etc. There is a strong feeling in the House Ways and Means Committee to add to all of this a sales tax, so he doesn't see that there is any sense in even discussing an enforced savings plan. Such would simply mean complete wreckage and under the circumstances it is absurd. On the other hand, if all things proposed are done, people will buy bonds simply because there won't be anything else for them to do with their money. For a like reason, he is not afraid of redeemable bonds because there will not be any reason for redemption, simply because there will not be any need for money. However, he doesn't want any more dedeemable bonds other than those that are now being issued. He doesn't see how the Treasury can announce any plans - there are altogether too many unknown factors. He doesn't even want a pattern for maturities such as has been suggested by a number of the other gentlemen.

Brown sums up the view of the members of the Council as shown by the discussion: 1. Compulsory savings should not be tried except as a last resort and all possible pressure should be applied to cause people to buy bonds voluntarily. 2. No new forms of redeemable bonds should be issued. The majority of the Council believes that the limit of permissible subscriptions in a year to F and G bonds should be raised from $50,000 to $100,000. 3. No fixed scheme of financing should be adopted and announced, though some members believe that there should be an announcement that there would be available for insurance companies and the like long-term issues put out at reasonable intervals and, likewise, short-term issues for banks.

Young says that Senator George has suggested that people be allowed to deduct from their gross income the amount of bonds purchased, provided the purchasers agree to hold the bonds until the end of the war, and at the time when the bonds are presented for payment the amount cashed should be added to the income. In other words, it would be a deferred income tax.

Brown doubts the advisability of raising these tax problems with which the Council hasn't anything to do.

EXCESS RESERVE SITUATION

Brown asked (1) Whether the Council believes reserve requirements in the country as a whole should be reduced? All members opposed. (2) Should reserve requirements in New York and in Chicago be reduced by bringing about a reclassification of reserve cities, i. e., abolish central reserve cities or reduce the number of reserve cities by means of reclassification and doing away at that time also with central reserve cities?

Harrison says that if you undertake to keep the bill rate at 3/8%, then excess reserves must be increased. The fear of the Treasury is that if the bill rate goes up it will affect the long-term rate and cause this to go above 2 1/2%. Harrison doubts whether this is true and he points to the experience of Great Britain. He claims that the Federal Reserve Board is inconsistent because it does not want excess reserves forced up and, at the same time, wants the bill rate maintained at 3/8%. Harrison does not want a reclassification, but would let the 3/8% rate go higher.

Brown says Council believes there should not be any reclassification nor any change in reserve requirements at present. He thinks there isn't any reason why the Open Market Committee should not continue to help those New York banks which find themselves short of reserves.

REGULATION W

Regulation of installment credit with reference to the recent regulation of personal loans of $1,500 or less.

Fleming reads a memorandum on the proposed tax rates and their effect on people or corporations heavily in debt. He suggested that it might be well if it were permitted to deduct from gross income the amounts actually paid out for retirement of debt. He promised to send a copy of his memorandum to each member of the Council.

Wallace thinks the $1,500 debt discussion had better be postponed until it is seen how the new Regulation works.

On Wakefield's suggestion, it is agreed that the Board be told the new Regulation is expensive, irritative, makes for bad relationship between banks and their customers, and doesn't accomplish any worth while object.

REGULATION V

Brown says the Treasury would like to get away from advances and finance all contracts under 90 per cent guarantee. By getting away from advances, Treasury would be able to postpone to a slight extent a certain amount of Treasury financing. The Federal Reserve Board would like to do away with advances because these have been one of the causes of increases in bank deposits. Also, if there are not any advances, banks will have more earning assets. The War and Navy Departments and the Maritime Commission are glad to do away with advances because they feel that if the banks have an interest in a loan they will supervise and police such a loan. Certain difficulties, however, have arisen: (1) Corporations that are acquiring huge inventories and have been finances by the government can wait for two or three years for a final settlement and adjusting claims with the government if and when the war suddenly ends. Furthermore, corporations under such circumstances have not used their ordinary bank lines and these will then be available for peace-time work whenever the war ends. If, however, the financing has not been done by means of advances, cor orations fear that they will have difficulty getting back promptly on a peace-time basis. It has been suggested that when and if contracts are cancelled, the government immediately take up its 90 per cent guarantee. But even the remaining 10 per cent consists of such large amounts that this is not enough. One suggestion is that the government take up contracts on cancellation completely, i. e., for 100 per cent, but that is objected to on all hands. (2) Smaller concerns with insufficient capital and experience find that banks regard even a 10 per cent risk as too much. There will, however, be a drive on the banks to c mpel them to take such loans and the banks will be sure to suffer heavy losses. So far, however, all 100 per cent guarantees have been refused and the whole scheme up to date has been a complete dud. Concerns like Allis Chalmers and Company and Union Carbide are being urged to apply for a guarantee simply in order to act as "bell-wethers." They do not themselves, of course, need any guarantee in order to obtain money from banks. It must be pointed out that, on the whole, the Federal Reserve Board has been fighting the battle of the banks and the corporations, but without much success.

Kurtz points out that in recent war contracts the clause has been omitted which protects the banks against claims by the government, especially claims for income taxes. It is agreed that the Board's attention should be called to this subject.

Brown points out that while the federal Reserve Board and the Comptroller's Office have stated that the guaranteed portion of the loan need not be considered in figuring legal limit, it ought to be made clear that this does not protect the officers and directors of a bank making loans beyone the legal limit.
All that it does is to hinder bank examiners from criticising such excess loans. It is agreed that if excess loans are to be made, there had better be amendatory legislation.

CURRENCY HOARDING

Brown thinks it undesirable to make any effort to have the regulation restored which existed at the time of the moratorium.

Adams states that banks should not place a burden on the Federal Reserve System by having it collect non-par items. He states that this is costing the System $668,000 a year. He says only a few cities in the country receive any benefit from this and he thinks it is a very selfish performance.

Brown replies that it would mean that all the small banks would have to send their items to their city correspondents who would charge them for the service. Politically, this would be very dangerous.

The meeting adjourned at 5:30 p. m.

Secretary's Notes on Meeting of the Federal Advisory Council on May 18, 1942 at 9:30 a. m. in the Board Room of the Federal Reserve Building, Washington, D. C.

All members of the Council were present except Mr. Fleming.

Brown reviews conclusions of yesterday.

Harrison states it should be made clear that the Council's position on reserve requirements is just for the present; a change might be needed sooner than expected. If nothing id done then short term rates must be flexible. The Treasury wants the present short term rate maintained in which case excess reserves must of necessity be kept at a high level.

The meeting adjourned at 10 a. m.

Secretary's Notes on Joint Meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council on May 18, 1942 at 10:35 a.m. in the Board Room of the Federal Reserve Building, Washington, D. C.

All members of the Council were present except Mr. Fleming who joined the meeting at 10:45.

The following members of the Board and their staff were present:

Messrs. Eccles, Ransom, Szymczak, McKee, Draper, and Evans; also, Messrs. Clayton, Morrill, Bethea, Carpenter, Wyatt, Goldenweiser, Smead, and Parry.

Brown states that the Council does not have any resolutions or recommendations to offer but wishes to discuss a number of matters.

WAR FINANCING

Brown states that the council believes that compulsory savings should be used only as a last resort. Ability to obtain as large an amount as might be possible from voluntary subscriptions suffers from too much talk in Washington about compulsory saving. It would be desirable if there were less talk by officials in Washington about compulsory savings until it has been found out how much can be done by a campaign directed to obtain voluntary subscriptions.

McKee wants to know if everything possible has been done to push the sale of defense bonds.

Brown thinks as regards the F and G bonds only the surface has been scratched. It may be that everything possible is being done in connection with the sale of E bonds. Answering a question of Ransom, Brown says that in the case of compulsory savings it is impossible to distribute the burdens in an equitable fashion. It is obviously impossible to consider all personal factors. He points out that while the so-called white collar class has received only small increases in wages, mechanics usually without many family responsibilities have had very suddenly very large increases in wages. Nevertheless, no differentiations would be made between these two classes.

Wakefield points out that like taxes, compulsory savings would have to be levied without making any personal distinctions. It would involve too much expense for the Treasury to find out what the various personal situations are.

Ransom says difficulties in that respect are no greater than in other fields.

Wakefield maintains that compulsion is not necessary because with the increase in rationing the majority of wage earners would have no place left in any event to put their money except to invest in government bonds.

Ransom says there are three places where people may put money: (a) pay taxes, (b) pay debts, and (c) buy bonds.

Wakefield says that the uncertainty in regard to the tax levy, the regulations in connection with small loans and similar matters, all bear so much on the problem of compulsory savings that it would seem to him impossible to do anything about this at present.

Eccles says he was on the President's Committee to consider the question of voluntary versus compulsory savings. Other members of the Committee were the Vice President, the Director of the Budget, the Price Administrator, the Secretary of the Treasury,and the Secretary of Agriculture. He believes federal expenditures by the end of the year will amount to about $200,000,000 a day. The purchase of consumers goods will undoubtedly in course of time diminish very rapidly but at the present time inventories are still high. However, as consumers are trying to buy up what they can, the chances are that the inventories will also disappear quite rapidly. It has been estimated that after the tax program now proposed is in effect, the gap between supply and demand will amount to about 10 to 15 billion dollars by which is meant that consumer purchasing power will exceed the possibility of supplying consumer demand by about the amount stated. This figure is given after allowing for the repayment of debts and after allowing for 2 billion dollars additional being taken for social security and after war bonds have been purchased. Henderson says it is impossible to control all prices if the gap is not more or less closed. If the gap remains, in order to control prices it will be necessary to ration everything and that is administratively an impossible job. Henderson believes that enforced savings and much heavier taxes are inevitable. If something is not done, there will be a great danger of a black market. Therefore, everything should be done to close the gap and thus avoid extreme price control and extreme rationing. The Treasury is opposed to enforced savings. Eccles feels that likewise freezing of wages will become necessary. It is impossible to do these jobs partially, and it is necessary to have an over-all program. The minute there is pressure the danger is that people will cash in the bonds they have purchased, for at the present time war bonds are simply a demand liability upon the Treasury and are just the same as demand deposits in banks. The only way to deal with inflationary pressures is to have a compulsory plan for everything: wages, savings, and taxes. He believes that at present people are buying bonds with money which would normally go into savings banks and into various forms of investment and that in most cases the money does not come from a curtailment of expenditures. The only way out is by coercion of some kind or other. He agrees that coercion is not equitable but after all coercive pressures used to get "voluntary" savings also is not apt to be equitable. Taxes might accomplish the same result but to go that far with taxes is simply not politically feasible. At present, our normal taxes are 15 per cent as against 32 per cent in Britain. Eccles' group believes the exemption for married people should not be more than $1,000 and for single people not more than $500 and then if there were a withholding tax of at least 10 per cent and enforced savings took another ten per cent we would have a reduction of 20 per cent in consumer purchasing power. Britain has compulsory savings on top of a 32 per cent normal income tax. He could not understand why so much talk about personal situations for, after all, neither in the case of taxes nor in the case of military service are personal situations taken into account.

Wakefield says there is not any basic difference between the views of the Council and Eccles. But at the present time an attempt is being made to follow a certain plan and this ought to be tried out. Nothing should be done until all parts of the proposed program can be put into effect.

Eccles agrees with that. He agrees that all possible effort must be made at present to make the voluntary plan effective.

Kurtz disagrees with Eccles as regards the compulsory plan not being more inequitable than military service or taxes. He points out that the service act is a selective service act and the taxes also make some allowance for different situations. He believes that a sales tax would be much better than compulsory saving.

Eccles says the Treasury feels a sales tax, in order to get anywhere, could not have provision for exempting some classes of goods. He points out that under a voluntary plan pressure may be put on some classes least able while mechanics and others who are benefitting most from the war effort would not be subject to such pressure as certain classes of city employees like policemen and firemen.

Harrison suggests there might be an expenditure tax similar to the present income tax but in addition to it and not a substitute.

Ransom speaks of a plan proposed in Britain whereby every one is to be allowed to spend 25 shillings a week and above that to have a graduated tax on all additional expenditures.

REDEEMABLE BONDS

Brown states that members of the Council do not favor any new kinds of redeemable bonds. The majority of the members would like to see the limit for F and G bonds raised to $100,000. The Council does not regard it as feasible for the Treasury to announce details of further financing but it might be well if it were understood that there would be issues of long-term bonds available at stated intervals and that there would also be a supply of bills and also bonds for banks, running in the case of bills from three months up and in the case of bonds running to a maturity of 10 years. Such a plan would be only good for the next few months for none of us can see into the future but without making any definite commitments there might well be some general understanding so that banks, insurance companies, and corporations could make some plans for the immediate future.

Eccles says there is not much to discuss. The Board is in disagreement with the view expressed by the Council and is so on record. If banks are the ones to invest corporate funds the process is an inflationary one. If the government spends 200 million dollars a day, in order to prevent inflation there must be some offset. But whatever is done there would be a large gap and it all means much larger bank deposits and more bank investments.

Brown states that Eccles has not argued against the Council's view. He points out that corporations want market securities and not redeemable, non-negotiable instruments as proposed by the Board and the presidents of the various Federal Reserve banks. Wakefield says he found there are few corporations in his territory that have funds to invest.

Eccles says this is passing as inventories and non-defense industries are being liquidated and therefore corporations are coming into possession of large cash resources. Also all new construction will soon cease.

McKee says he cannot see any harm in having as many issues as are needed. It may be that there are funds which would be invested were suitable issues made available. Some issues may not work but he cannot see where any harm would be done.

Eccles says under present conditions the Federal Reserve System must support the market and what this amounts to is simply that demand liability is being shifted from the Treasury to the Federal Reserve System. The Board wanted a 5 year bond redeemable on notice after 6 months with graduated interest rates depending on the length of time the security is held. If the bond is cashed at other than interest dates there would be some slight loss of interest as is true now in the case of savings banks accounts. Thus the Treasury would be relieved of the need of selling a new issue every 6 months or every year as the case might be. As time went on the holder of these bonds would be less and less likely to turn them in as he would find his interest rate increasing, and it is conceivable that instead of redeeming the bond he might even borrow money in order to be relieved of the necessity of redeeming the bond.

RESERVES

Brown says the Council agrees with the Board that excess reserves should be regarded in connection with the country as a whole and not merely from the point of view of the New York City banks. He believes the Treasury must get its money where money is being spent. New York and Chicago should not be reduced to reserve cities for on account of the fact that New York and Chicago hold a large portion of the correspondent bank funds of the country, deposits in these two cities fluctuate much more than elsewhere.

Eccles suggests that New York and Chicago be treated separately as regards changes in required reserves. He points out that at present reserve requirements for country banks can be changed but changes in reserve requirements for banks located in reserve cities and central reserve cities must be made prorata for both and they cannot be made separately for one of these classes.

Brown says he would be opposed to that and so would the presidents of the New York City banks. He believes that any alterations in reserve requirements should be for both reserve and central reserve cities. The Council believes the present practice of the Open Market Committee to buy bills directly from a bank when a bank needs funds is right. There is a fear that if Chicago and New York were to be treated separately that such power might be used to coerce New York.

Eccles points out that the Board now has the power to reclassify the central reserve and reserve cities and, therefore, without any further legislation could in practice abolish the central reserve city classification as separate from the reserve cities.

McKee believes there should be more elasticity in the reserves. At present the differentiation in reserve requirements between central reserve and reserve cities is too great. Even if there were a change in requirements it might be provided that requirements for central reserve cities be higher than for reserve cities but the difference need not be as great at present. He explains that what he means is when the required reserves from reserve cities was 10 per cent and from central reserve cities 13 per cent, the differential was only 3 per cent, but when these requirements were doubled the differential became 6 per cent.

Harrison says if the power to change reserve requirements was left to the Open Market Committee, the fears of New York and Chicago would be very much lessened. He feels that if the power were left to the Open Market Committee he would not have any objection to having a reclassification such as was suggested by Mr. Eccles and in fact this was proposed in the joint statement of December 31, 1940, put forth by the Federal Reserve Board, the presidents of the Federal Reserve banks and the Federal Advisory Council. Eccles says that he agreed to this proviso only in connection with the whole proposed plan, which it might be recalled, included the suggestion that all banks in the country be put under the control or regulation by the Federal Reserve System. He would not be in favor of the proposed plan if all banks were not to be included.

McKee brought up his proposal for permitting deficiency in reserves under certain circumstances which he had presented at an earlier meeting of the Council.

Eccles says he will propose a change in the act to permit a deficiency in daily reserves. Brown says that the Council would support the Board in such a move.

REGULATION W

Brown states that the Council does not desire to have any argument about the amendment pertaining to loans of $1,500 and under, recently issued by the Board. The Council realizes it is now water over the dam and that the amendment has not been in operation long enough to pass any judgment. The Council merely wishes to point out at this time that the amendment is very expensive for smaller banks, that it makes for bad public relations between the banks and their customers, and that there is not enough to be gained by it to justify it. He would prefer that a detailed discussion be left for the next meeting of the Council.

Ransom says it is all a part of the President's Seven Point Program. The Board felt that under the Seven Point Program every loan ought to be subject to Regulation W but that such regulation was not feasible. Hence Regulation W was amended so that the same limitation as was provided for under Regulation W for certain forms of credit should be made to apply to all forms of credit. If at any time this amendment should create administrative difficulty, he hopes that the facts will be called immediately to the attention of the Board.

REGULATION V

Brown raised the problem of the legal limit on loans and points out that in spite of the Comptroller's circular, banks are not protected in the event of loss if a loan is made by a bank beyond its legally permitted limit.

McKee says that a bill is to be introduced on Wednesday by an Illinois Congresswoman, Jessie Sumner.

The meeting adjourned for lunch at 1:15 p. m.

Secretary's Notes on Joint Meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council on May 18, 1942 at 2:30 p. m. in the Board Room of the Federal Reserve Building, Washington, D. C.

All members of the Council were present except Mr. Fleming.

The following members of the Board and their staff were present:

Messrs. Eccles, Ransom, Szymczak, McKee, Draper, and Evans; also, Messrs. Clayton, Morrill, Carpenter, Bethea, Wyatt, Vest, Goldenweiser, Smead, Parry, and Kenton Cravens.

Brown discusses the assignability of contracts. He states that the attention of the Council has been called to the fact that the clause which protected banks in the case of subsequent income tax claims or the like is being omitted. He continues to point out that loans are made on letters of intent, and frequently banks do not have the contract in its final form until some weeks or months have elapsed after the loan has been made. There are cases where the goods have been manufactured and shipped before the contract has even been signed. If, however, the government departments persist in deleting the clause protecting the banks against reductions or set-offs for any indebtedness of the contractor to the United States arising independently of the contract in question, then it will be impossible for banks to lend, as at present, on supply contracts or the like.

Eccles asks the Council to submit the facts in a formal letter to the Board, and the Board will be very glad to use its good offices. He raises again the subject of the redeemable bond running for five years with an increase of interest every six months.

Brown states that the Council will consider the matter further.

REGULATION V

Brown says that contractors who have been getting advances do not wish to be in a position of borrowing on a 90% guarentee where large amounts of unused inventory, plant, contracts to buy, and a very large debt in proportion to capital are involved. If the contractor has been receiving advances then he is in a position to wait months or even years before a final adjustment is made with the government; but if he has a note guaranteed in part, he may not be able to resume peacetime production when and if the war ends.

McKee admits that subcontractors are not protected sufficiently, but if the War and Navy Departments or the Maritime Commission were to buy a claim from the subcontractor on the 90% or some other basis, the subcontractor could appraise his situation and get the matter off his hands. As regards the prime contractor, he would simply have added to his claims for damages that of the subcontractor.

Brown points out how advances will protect the prime and subcontractors, but if his financing has not been based on advances, there are possibilities that the contractors will not be able to get back to work immediately after the war.

Eccles says all that has been stated is perfectly true, but if the government were to continue to make advances in all cases, it would simply mean that the government would be doing all the financing without having any adequate means for policing contracts; the government is also hampered by an insufficient knowledge of credits. Loans will no longer be made through normal channels.

Brown says the banks are doing their best to help, but he is convinced that some contractors will simply fold up if there are not to be any advances.

McKee says supposing a 2 1/2% interest charge is to be made for advances, and that such interest charge could not be added to expenses even in those cases where the work is being done on a fixed-fee basis. On the other hand, if a contractor uses his own credit, then the interest he pays out could be added to his expenses. What then?

Cravens. Both section 5 and 6 will help banks and contractors. These sections provide that if cancellation takes place, the amount of the unguaranteed portion of the loan is automatically reduced. After it is determined to cancel, the borrower has one year to wind up the matter or he must obtain an extension or a settlement of his claims. Interest during the period of suspension is to be waived. He admits that these sections probably protect the chief subcontractor but not the sub-subcontractor and those still lower in the scale. There is now pending a new form which he believes will protect banks still further in certain respects. He states, however, that with some minor exceptions, the form of contract is now frozen.

Eccles thinks that the risk to the banks has been reduced to a minimum. After all, if the government is to give a 100% guarantee it will not need the banks at all, and the banks then would find themselves very soon without any loans. He points out the need of decentralization and believes it necessary to try out the present plan. One of the desires is to weed out mere promoters who are not entitled to either credit or confidence in their managerial ability.

Draper states that so far there have been made 136 guaranteed loans amounting to $53,000,000. This is just after a month of operation.

The meeting adjourned at 4 p. m.

Secretary's Notes on Meeting of the Federal Advisory Council on May 18, 1942 at 4:05 p. m. in the Board Room of the Federal Reserve Building, Washington, D. C.

All members of the Council except Mr. Fleming were present.

Brown. The question of a redeemable five-year issue has been raised by the Chairman of the Board. He states his understanding is that the units of this issue are to be relatively large, namely, $5,000 as a minimum.

Spencer does not think there is any need for such an issue.

Brown says he understands that this issue is to have a higher rate than any market issue. Banks would not be allowed to buy it and corporations would buy it in preference to regular market issues as it would bear a higher rate. The result would be that market issues would be bought in practice only by banks.

Kurtz doubts whether the yield would mean much as most of the people or corporations who would buy this sort of a security would be in the higher brackets.

Harrison feels that in principle the Treasury should not create still more demand liabilities. If we are in the war three years longer, we may have $36,000,000 of E, F, and G bonds outstanding, and, at the end of the war, the Treasury would be faced with a huge demand liability. There would then be only three ways to meet the situation: (a) a forced conversion such as took place in Britain after the last war; (b) purchases by the Federal Reserve System, and (c) greenbacks. While it is true that at the end of six months this proposed new issue would have a higher yield than the G bonds, after a year it would begin to be the other way. He believes that if the limit of annual subscriptions to the G bonds were raised to $100,000 it would meet all needs. The idea of redeemability after six months and for this purpose to put out a five-year issue is bad fiscal policy. No one knows how much could be sold. Eccles seems to have in mind smaller retailers who are liquidating their inventories. Harrison would like to preserve orthodoxy in financing as much as is possible under existing circumstances.

Kurtz is certain that the G bond limit will not be increased to $100,000. The treasurer of a small business does not know how long a maturity the security which he buys should have, but in any event, if, let us say, $2,000,000,000 of this sort of issue is sold it would relieve the banks to just that extent. He questions whether such an issue would really create any new problems for the Treasury.

Brown doubts whether the corporations would buy more of this issue than they would of a marketable security if there were available issues of 1, 2, 3, 4, and 5 year maturities.

Harrison. The test of success of the present plan of the President and the Secretary of the Treasury will be if we can sell $12,000,000,000 of E, F, and G bonds. The proceeds of the new issue would not be included, and, consequently, it might prejudice the success of the present plan.

Young thinks the present plan should first be tried out. If it does not work, it will be time to try out Eccles' plan of a new issue.

A vote was taken with the following results:

| | |
|---|---|
| Young | - No at this time |
| Wallace | - No at this time |
| Wakefield | - No at this time |
| Spencer | - No |
| Ragland | - No |
| Adams | - No |
| Huntington | - No |
| Kurtz | - Yes |
| Harrison | - No |
| Clark | - No at this time |
| Brown | - No |
| Fleming | - Absent |

Consequently, the result is that four of the members voted no at this time, six voted simply no, and one voted yes. It was agreed that Mr. Kurtz and the Secretary of the Council are to prepare a letter to be sent to the Board dealing with the problem of off-set clauses in contracts in connection with war production.

Messrs. Adams, Wallace, and Clark left the meeting at 4:25 p. m.

At 4:30 p. m. Dr. Goldenweiser joined the meeting and discussed various aspects of the present financial and business situation.

QUESTION OF RESERVE SITUATION IN NEW YORK AND ITS EFFECT ON MONEY RATES

Goldenweiser. There has been a large decrease in the excess reserves held by New York City banks. The low point is about $400,000,000, and, at present, the excess reserves in New York City banks amount to about $700,000,000. This is really healthy as it tightens the short-term rate and brings the money market more under the control of the Federal Reserve authorities. A 3/8% rate for bills has really been established, and, at that rate, Federal Reserve banks will buy any bills offered by any bank. It is the first time in almost 10 years that the Federal Reserve System is in touch with the money market. Formerly, acceptances were bought at fixed rates by the Federal Reserve System and there were also rediscounts. Now the market can get credit by selling bills and this is a healthy and desirable development. The Treasury, of course, would like to see excess reserves in the country to amount to about $5,000,000,000 and $2,000,000,000 in New York. The present situation is much healthier and accomplishes all that the Treasury wants. The development in New York is due to the loss in currency as the Treasury spending is more outside of New York than in New York, while New York has bought a large prop rtion of the various government issues. Previously, this was offset by the influx of gold which, however, ceased last year. There is not any cause for alarm. At one time in the 20's the belief was that New York banks had to be in debt to the Federal Reserve System to the amount of $50,000,000 or the money market would be weak. There are not any substantial excess reserves required, as most of the banks have bills which they can sell to the Federal Reserve System. It might be well if the rediscount rate were reduced to the same rate as the bills so the banks which do not have bills would not be subject to any penalty.

Brown thinks so low a rate would affect the psychology of borrowers and they might object to even the present low commercial rate of 1 1/2%.

Goldenweiser continuing. It would be too bad if reserve requirements were reduced. The flow of funds from New York will slacken and the situation will adjust itself. It is important for the Treasury to have paper of various maturities so as to meet all needs. Apparently no interest is being taken in the type of issue suggested by Chairman Eccles. Consequently, Goldenweiser agrees with the majority view of the Council.

Production index is going to go up in April to 174 from 172 in February and March. In May it is likely to be still higher. Conversion has therefore not checked production to any extent. Consequently, unemployment did not develop as much as was expected. We are now about 45% in war production, and probably this percentage will soon cease growing. There are still large amounts of labor available: women, young people, etc. For at least two years there is no danger of any labor shortage. The problem of inflation is still with us which means the difference between the amount of money available and the amount of goods available for purchase by consumers. Much guess work is involved. There is much less danger than formerly because there is a realization of the danger. Taxes and ceiling on prices will do much. Agricultural prices and wages are tied up with politics, but there is some control and probably will not be any serious trouble. If there is to be compulsory saving there ought to be allowances made for previous commitments. The danger in voluntary savings is that instead of an equitable pressure, we have vicious and uncontrolled pressures. Rationing undoubtedly will come in time. Whether or not control of consumer will mean much in connection with the war effort, it may be a good thing in time of peace. Quite possibly there will not be any inflation, and it is quite certain there will not be any run-away inflation. On the whole, the job is being pretty well done. Our problems from now on will be physical problems and not financial or monetary problems.

The meeting adjourned at 5:20 p. m.