

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

December 3, 1944

The fourth statutory meeting of the Federal Advisory Council for 1944 was convened in Room 1032 of the Mayflower Hotel, Washington, D. C., on Sunday, December 3, 1944, at 2:10 P.M., the Vice President, Mr. Spencer, in the chair:

Present:

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|---|-----------------|
| Mr. Charles E. Spencer, Jr. | District No. 1 |
| Mr. John C. Traphagen | 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. Keehn W. Berry | District No. 6 |
| Mr. Walter S. McLucas (Alternate for Mr. Edward E. Brown) | District No. 7 |
| Mr. Ralph C. Gifford | District No. 8 |
| Mr. Lyman E. Wakefield | District No. 9 |
| Mr. A. E. Bradshaw | District No. 10 |
| Mr. Ed H. Winton | District No. 11 |
| Mr. George M. Wallace | District No. 12 |
| Mr. Walter Lichtenstein | Secretary |

The minutes of the meeting of the Council of September 17-18, 1944, a copy of which had been previously sent to each member of the Council, were approved.

It was decided to ask the Board of Governors about the present status of the bill dealing with Regulation Q.

At the suggestion of Mr. Wallace, it was decided to ask the Board of Governors to have the term "loan" in the pending bill to amend Section 13b of the Federal Reserve Act defined as follows:

"The term 'loan' as used herein shall be construed as referring to a loan, discount or advance, including *participation* therein, and the term 'guarantee' as used herein shall be construed as including a commitment to make such guarantee."

The Board of Governors had submitted to the Council the suggestion that it discuss the criticisms appearing in Congress as to the earnings of banks on the government debt.

A lengthy discussion took place in which the Council formulated its views somewhat as follows:

The Council feels if anything is wrong in connection with the growing predominance of Government securities in bank earnings, it is that there is a certain maldistribution which, however, is due to the methods of the Treasury. In addition, it should be pointed out that the published figures of bank capital are nearly always considerably lower than they are in actual fact. Furthermore, the limit of bank earnings is in sight, due to the taxation on excess profits. Finally, it should be pointed out that the capital structure of banks is still inadequate and the increase in dividends paid by banks is less than in almost any other line of business or industry.

The Council also expressed the view that any increase in bank dividends should be on the most conservative basis.

The meeting adjourned at 4:25 P.M.

WALTER LICHTENSTEIN,
Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

December 4, 1944

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

Present: Mr. Charles E. Spencer, Jr., Vice President; Messrs. John C. Traphagen, William Fulton Kurtz, B. G. Huntington, Robert V. Fleming, Keehn W. Berry, Walter S. McLucas, Ralph C. Gifford, Lyman E. Wakefield, A. E. Bradshaw, Ed H. Winton, George M. Wallace, and Walter Lichtenstein, Secretary.

There was a discussion of the program agreed upon at yesterday's meeting.

The meeting adjourned at 10:15 A.M.

WALTER LICHTENSTEIN,
Secretary.

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

December 4, 1944

At 10:30 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, and Ernest G. Draper; also, Messrs. Lawrence Clayton, Assistant to the Chairman; Elliott Thurston, Special Assistant to the Chairman; Chester Morrill, Secretary of the Board of Governors; S. R. Carpenter and Bray Hammond, Assistant Secretaries; Walter Wyatt, General Counsel; J. P. Dreibelbis, General Attorney; George B. Vest, Assistant General Attorney; E. A. Goldenweiser, Director, Division of Research and Statistics; Leo H. Paulger, Director, Division of Examinations; Edward L. Smead, Director, Division of Bank Operations; Carl E. Parry, Director, Division of Security Loans, and Robert F. Leonard, Director, Division of Personnel Administration.

Present: Members of the Federal Advisory Council:

Mr. Charles E. Spencer, Jr., Vice President; Messrs. John C. Traphagen, William Fulton Kurtz, B. G. Huntington, Robert V. Fleming, Keehn W. Berry, Walter S. McLucas, Ralph C. Gifford, Lyman E. Wakefield, A. E. Bradshaw, Ed H. Winton, George M. Wallace, and Walter Lichtenstein, Secretary.

Governor Ransom discussed the situation in respect to Regulation Q and stated that hearings were likely to be held on the Maybank Bill by the Senate Committee on Banking and Currency.

In respect of the ratio of gold to member bank reserve balances and Federal Reserve notes in circulation, Chairman Eccles stated that legislation would be needed after the first of the year. He argued that gold reserves are not really needed at all and other central banks do not have any such requirements at this time. In the case of the Bank of England and the Bank of Canada, all reserve requirements have been suspended. He also argued that the provision permitting Federal Reserve banks to deposit bonds as a guaranty for Federal Reserve notes ought to be made permanent.

In respect to the amendment to Section 13b, Chairman Eccles stated since the Smaller War Plants Bill had been enacted into law, he doubted whether Congress would take any action in respect to the proposed amendment to Section 13b of the Federal Reserve Act.

There was general agreement by the Council and the Board of Governors that in general banks should invest in short-term government securities and that on the whole it would be desirable that the earnings of banks should not increase largely at this time.

The meeting adjourned at 12:30 P.M.

WALTER LICHTENSTEIN,
Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

December 4, 1944

At 12:35 P.M., the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the Vice President, Mr. Spencer, in the chair.

Present: Mr. Charles E. Spencer, Jr., Vice President; Messrs. John C. Traphagen, William Fulton Kurtz, B. G. Huntington, Robert V. Fleming, Keehn W. Berry, Walter S. McLucas, Ralph C. Gifford, Lyman E. Wakefield, A. E. Bradshaw, Ed H. Winton, George M. Wallace, and Walter Lichtenstein, Secretary.

Dr. Goldenweiser appeared before the Council and gave an account of some of the economic forces, notably the monetary ones, which are likely to prevail after the war.

The meeting adjourned at 1:00 P.M.

WALTER LICHTENSTEIN,
Secretary.

NOTE: This 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 December 3, 1944, at 2:10 P. M., in Room 1032 of the Mayflower Hotel, Washington, D. C.

All members of the Federal Advisory Council were present, except that Mr. Walter S. McLucas served as alternate for Mr. Edward E. Brown. As Mr. Brown was not present, the Vice President of the Council, Mr. Charles E. Spencer, Jr., presided.

Mr. Winton was not present when the meeting began but arrived at 3:10 P. M.

The minutes of the meeting of the Council of September 17-18, 1944, copies of which had been previously sent to the members of the Council, were approved.

REGULATION Q

It was decided to ask the Board what the present status was.

LIBERALIZATION OF 13B

Wallace. The language defining the term "loan" should be the same as it appears in the V loans.

Spencer. It might be well to present to the Board the suggestion made by Mr. Wallace, reading as follows:

"The term 'loan' as used herein shall be construed as referring to a loan, discount or advance, including participation therein, and the term 'guarantee' as used herein shall be construed as including a commitment to make such guarantee."

It was agreed to discuss this matter with the Board.

BANK EARNINGS ON GOVERNMENT SECURITIES

Berry read a memorandum bearing on the issue of Government securities and he pleads that long-term bonds (five years and more)

should be issued to the public and short-term loans restricted to banks.

Fleming says the Treasury seems to want a lower rate than at present.

Wallace states that at the last drive three-fifths of the sales were bonds but about \$50 million were bought on which premiums had to be paid to dealers and others.

Fleming says insurance companies can buy for about \$2 billion in new money each year. Corporations will sell their seven-eighths and similar holdings and these, therefore, ultimately, will have to be taken up by the banks.

Traphagen says corporations will not buy bonds which they can not sell readily.

Kurtz says in his area corporations are not buying bonds.

Berry. If one and one-quarter per cent paper were increased in volume, this would probably go to the smaller banks and thus increase the earnings of such smaller banks and take the holdings out of the banks in the larger centers. In other words, the smaller banks should be given a better chance than they have at present.

Spencer raises the question whether the Treasury can do a refunding job at this time.

Wakefield. There should not be any effort made to refund short-term securities such as bills and certificates. These short-term securities enable banks to invest their reserve funds, and it gives them a little return and at the same time maintains their liquidity. It gives the Treasury \$40 billion at a very low rate. Small banks should buy the two per cent bonds and pay a premium if necessary.

Kurtz. In the Third District small banks have actually bought more short-term securities than have the big banks.

Berry. Berry says a program ought to be developed which would distribute earnings better than they are distributed at present.

Spencer wants to know if it isn't true that if banks get into the excess profits bracket whether they will not prefer smaller earnings on account of the whole tax situation.

Wallace thinks at the present time the program should not be disturbed for it would be very undesirable to have the average rate of interest which the Government pays increased.

Wakefield says that there would be no advantage that he can see

in refunding bills and certificates.

It is at this time that Mr. Winton joined the meeting.

Winton. There was too much short-term financing a few months ago but that has probably come to a conclusion. He believes the Treasury is right in its program and it is good to have the short-term financing as it gives the banks more liquidity.

Spencer proposes the second question asked by the Board -- whether short-term debt should be refunded.

Kurtz states that on the whole the Council thinks it better to wait with any refunding until the situation has stabilized. He does not think this is the time to try any refunding.

Traphagen believes the Government must keep the service on the debt as low as possible and he questions the wisdom of refunding at this time even if it could be done. He moves that the answer to the question raised by the Board be "No", to which Fleming adds that the Government should sell as many long-term securities to the public as possible but that there should not be any refunding. There is general agreement to this proposal.

Wakefield says when people begin to spend and cash in their bonds the banks will have to take over and then banks should try to have as much of short-term securities at low rates as possible because otherwise bank earnings will increase and there would be agitation to have the Government take over the whole banking system.

Berry wants medium-term securities to go to small banks.

Spencer proposes the second question asked by the Board -- whether a larger portion of the earnings of banks should be retained for additions to capital and surplus rather than paid out in increased dividends.

Kurtz points out that increase in earnings since 1940 was only 23-1/2 per cent as against 100 per cent increase in deposits. Dividends actually in that period went down 1 per cent. Taxes went up 100 per cent while salaries and wages went up 22 per cent. He does not think the allocation of securities is really very bad. He gives the following table:

| | (Amounts in thousands of dollars) | | | | |
|------------------|-----------------------------------|------------|------------|------------|-------|
| | 1940 | 1941 | 1942 | 1943 | % |
| Net Earnings | 402,000 | 429,000 | 418,000 | 496,000 | +23.5 |
| Dividends | 210,000 | 211,000 | 203,000 | 208,000 | -1 |
| Taxes | 100,000 | 129,000 | 149,000 | 200,000 | +100 |
| Salaries & Wages | 400,000 | 426,000 | 470,000 | 487,000 | +22 |
| U.S. Gov'ts. | 14,823,000 | 17,753,000 | 25,408,000 | 48,182,000 | +225 |

Wakefield says there is a great danger to the banks in the movement inaugurated by Patman. The basic result of this would be a control of all credit by the Government and thereby ultimately all corporations and individuals would be subject to a rigid Government control. He believes the A. B. A. should devote itself to a campaign of education to show the implications inherent in the control of credit by the Government and the danger there would be in a costless financing of the war.

Kurtz replies that he believes there was more danger of such a development in the administration of Andrew Jackson than there is now.

Wakefield said a beginning of the movement was made with Regulation W. Eccles wanted selective credit control which would really mean complete governmental control.

The Council feels if anything is wrong in connection with the growing predominance of Government securities in bank earnings, it is that there is a certain maldistribution which, however, is due to the methods of the Treasury. In addition, it should be pointed out that the published figures of bank capital are nearly always considerably lower than they are in actual fact. Furthermore, the limit of bank earnings is in sight due to the taxation on excess profits. Finally, it should be pointed out that the capital structure of banks is still inadequate and the increase in dividends paid by banks is less than in almost any other line of business or industry.

The Council believes any increase in bank dividends should be on a most conservative basis.

The question should anything be done now is really answered in the two preceding paragraphs. This is certainly not the time to "rock the boat". The war situation is still such that it is too early to try to make any changes in the machinery at this time.

DECLINE OF THE RATIO OF GOLD TO MEMBER BANKS RESERVE BALANCES AND
FEDERAL RESERVE NOTES IN CIRCULATION

It was decided to discuss this matter with the Board.

The meeting adjourned at 4:25 P. M.

The Council reconvened in the Board Room of the Federal Reserve Building, at 10:10 A. M., on December 4, 1944.

All members of the Council were present, except that Mr. Walter S. McLucas represented Mr. E. E. Brown. The Vice-President of the Council, Mr. Charles E. Spencer, Jr., presided.

There was a discussion of the program agreed upon at yesterday's meeting.

The meeting adjourned at 10:15 A. M.

At 10:30 A. M., the Council held a joint meeting with the Board of Governors of the Federal Reserve System.

All members of Council were present except that Mr. McLucas represented Mr. Brown. The Vice President of the Council, Mr. Charles E. Spencer, Jr., presided. The following members of the Board of governors were present: Chairman Eccles; Vice Chairman Ransom; Governors Szymczak, McKee, and Draper; also, Messrs. Clayton, Thurston, Morrill, Carpenter, Bray Hammond (Assistant Secretary), Goldenweiser, Wyatt, Dreibelbis, Vest, Smead, Paulger, Parry, and Leonard.

REGULATION Q

Ransom. Hearings are to be begun in the Senate on Thursday. This may be an attempt to push the Bill through in this session, as Congress now is likely to remain in Washington until at least December 20. The Board will try to bring witnesses in opposition to the Bill. Congress might do one of three things: (1) it might repeal the prohibition against payment of interest; (2) it might specifically permit banks to impose exchange charges; (3) permit the Federal Reserve System to administer the provisions of the law. He believes the Bill can be defeated but it depends entirely as to whether bankers are willing to come and stay for the hearings. It is rather impressive that the Association of Credit Men and 28 of the State Bankers Associations, as well as the ABA and the Association of Reserve City Bankers are all opposed to the repeal of prohibition against interest and permission to impose exchange charges.

DECLINE OF THE RATIO OF GOLD TO MEMBER BANKS' RESERVE BALANCES AND FEDERAL RESERVE NOTES IN CIRCULATION.

Eccles states legislation will be needed after the first of the year. It was agreed unanimously by the Open Market Committee that the only frank and open way to correct the situation was by means of legislation. As far as the gold in the stabilization fund is concerned, this is being reserved to carry out the provision of the Bretton Woods Conference. As a matter of fact gold reserves are not needed at all and other central banks do not have any such requirements. A gold reserve under present conditions is a purely academic matter. He would prefer to have all such reserve requirements suspended as has been done in the case of the Bank of England and in the case of the Bank of Canada. If there isn't any correction in the situation, it would merely mean that the Federal Reserve System could no longer support the Government bond market and the Federal Reserve System instead of buying bonds would have to sell. This would create a very

serious situation. The provision permitting the Federal Reserve Banks to deposit bonds as a guarantee of Federal Reserve notes expires on June 30, 1945. As a matter of fact, the permission to do this should be made permanent, as there have not been any eligible bills for a long time so that unless the provision referred to is kept in force there would have to be a hundred per cent gold coverage behind the Federal Reserve notes which is utterly impossible at present. There is more currency outstanding now than can be covered one hundred per cent by gold without taking into account the gold coverage required against deposits.

A LIBERALIZATION OF SECTION 13b.

Spencer reads the formula presented by Wallace which is given in the minutes of yesterday's meeting.

Wallace feels that the statement in H.R. 4804 is not sufficiently clear and the definition of "loan" should be made to correspond with the provisions in the V loans.

Vest thinks the bill means the same without the formula introduced by Wallace as it would with it. In drafting the bill he tried to make it as short as possible and so omitted all definitions, expecting that regulations would take care of these matters. There is no objection to putting in the provision suggested by Wallace except that it would mean other doubtful terms would also have to be defined. He took it for granted that the Board would have the necessary power to define the terms of the law though that is not specifically stated in the Bill.

Eccles says the Bill is not likely to come up this session and so it will lapse and he does not propose to have it reintroduced in the next Congress. The Smaller War Plants Bill which has been passed takes care of the matter. It passed because no one appeared in opposition to it. It means that probably the so-called billion dollar bill will also be enacted into law and the result will be that the banks will meet with direct competition such as they have not had before. The bankers are to blame for this situation, for the ABA opposed the amendment to 13b and consequently there was nothing with which to oppose the Smaller War Plants Bill.

Fleming states in fairness to the ABA it ought to be pointed out that its position was taken in the Convention held in 1943 where a resolution was passed in opposition to all forms of guaranteed loans. It proved impossible to get the 1944 Convention to change this position.

BANK EARNINGS ON GOVERNMENT SECURITIES.

Spencer. As he understands it, refunding means transforming short-term debt into long-term debt. At the present time probably no more can be done than the Treasury is doing because new money is constantly being required.

McKee asks whether it would not be possible to increase the total volume of longer-term securities. Three to four year notes might be very helpful.

Eccles says there is an erroneous conception in respect to the need of refunding short-term debt. Bank earnings are becoming excessive. As a matter of fact it isn't a question urgent at this moment, but one which will arise during the postwar period.

Fleming. Corporations wanted securities of 7/8 per cent and 1-1/4 as they wished to build up depreciation reserves in the form of short-term securities which could readily be sold. When these securities are sold by the corporations, the banks will have to buy them.

McKee. More and more anxiety is being shown about short-term debt and if three to four year notes could be built up funds would be released for further short-term borrowing.

Fleming says the ABA committee suggested that the Treasury issue some 1-1/4 securities, but this was refused.

McKee says the trouble will come when corporations must sell, and he wishes to have the banks in a position where they will be able to buy the securities forced into the market.

Eccles disagrees as he believes it would be most dangerous to have the service on the debt increased. As a matter of fact, it would be preferable to have the rate brought down as the British succeeded in doing.

McKee feels there should be a better distribution of maturities.

Eccles doubts whether business during the reconversion period will sell anything like the amount expected. At present industry is carrying all its inventories and paying operating expenses. It must, therefore, be assumed that after the war the corporations will have their present inventories paid for and there will not be any need to sell bonds.

Wakefield. The problem is not a present one but relates to the welfare of the banking system and of industry after the war. There isn't any question that there will be great pressure upon Government and business after the war to provide for a very high level of employment. He believes the short-term securities will be sold by corporations and the banks will have to buy them, and he thinks it very important that the cost to the Government of servicing the debt be not increased. Consequently, he regards it desirable to have as much as possible in short-term securities and if this is done he doubts whether there will be any problem.

Eccles reads from a statement which he had prepared for the Open Market Committee and the Treasury some months ago. In this statement he points out that past tradition has been to refund short-term securities

into long-term ones and thus avoid a pressure for money at an inopportune time. He doubts whether this is necessarily true of a Government which completely controls the money market. If refunding were to take place now, the interest charge on the debt would be increased and a certain amount of flexibility would be lost. If the earnings of banks continue to mount, both they and the Government will be subject to attack. As a matter of fact, if the banks undertook to hold more and more long-term securities, they would be in greater danger of suffering losses. He pointed out that in his speech at Los Angeles, the Secretary of the Treasury predicted that interest rates will not increase; low rates encourage business and industry. There isn't any need for a wholesale refunding of short-term debt, for it will merely increase the cost to the taxpayer and also mean more risk to holders of bonds due to the possibility of a change in interest rates. So much for Mr. Morgenthau. Eccles himself believes that banks should hold as far as possible only bills and certificates, certainly in so far as these are held against demand deposits. He is sorry to see that banks are now tending to buy longer-term securities.

Wallace thinks people are short-term minded. We have not as yet approached the British situation. We have only about a third of our debt in short-term, while in the case of Great Britain it amounts to about one-half the total. He believes refunding is not possible at present and that as a matter of fact the proportion of short-terms should be increased rather than decreased.

Eccles says that banks went for the twos to such an extent that after the last drive the dealers did not have any supply of twos. It is curious to note that even between drives when the Treasury is drawing down the War Loan Deposit Accounts, banks did not sell bonds but actually bought bonds and instead sold \$3 billion in bills.

Berry says the British gave the banks bills bearing the rate of 1-1/8 and gave them in sufficient amounts so the banks could pay their overhead and their normal dividend requirements. With us, the smaller banks cannot meet their overhead by buying bills and certificates and as a result they buy longer-term securities.

Eccles doubts this and believes both larger and smaller banks are well taken care of. Banks should never have been allowed to take any securities bearing a higher rate than 1-1/2 per cent, but he did admit that the trend of bank earnings had not been foreseen.

Wakefield says excess profit tax is taking care of the situation. He wants banks to have short-term securities because for one thing no one can tell at this time what the shift of deposits may be. He doubts whether after this drive banks will be very much interested in the twos.

McKee says he wishes to make it plain that he is not interested in having the Government provide more earnings for banks, but there should be

enough variation in maturities to prevent long-term securities from going to too much of a premium.

Eccles. As long as you have a rate of $3/8$ anchored, it tends to pull the $7/8$ certificates down to $3/4$ because under these circumstances the $7/8$ certificates bear a premium. There isn't any problem as long as you maintain a $3/8$ buying rate. He believes it would be good policy for the banks at this time to reduce their service charges and pay their employees more so that the public would feel that the banks are sharing their prosperity with the public. It might also be well to raise the interest rate on savings.

Wakefield says he does not believe banks can afford to have their deposits represented by long-term securities and they really cannot afford to have higher earnings with the result that more and more short-term securities will be and should be acquired by the banks.

Eccles says he disagrees with the Comptroller of the Currency and the Federal Deposit Insurance Corporation as regards the capital ratio since, after all, Governments are the same as cash. With a \$300 billion debt represented by bonds held by the public, a declining bond market cannot be permitted, and in consequence the capital coverage in the banks is quite adequate under existing circumstances. If cash in banks, Federal Reserve balances, and Governments are deducted from the amount of deposits, the ratio represents about a 40 per cent coverage. This is more than has ever existed before, and besides, the remainder of the assets are loans far superior to those of the past.

McKee points out that in the future the large depositors will be really the ones to supervise banks for they will take their deposits wherever they are assured of the best capital structure.

Eccles says banks, and, for that matter, the Federal Reserve Banks, are becoming mere branches of the Treasury and this situation is not likely to change in any foreseeable time. Since 1929 the Government has created all sorts of agencies which practically refunded defaulted obligations. At present, about 75 per cent of the earning assets of banks are in the form of Governments, while in the case of the British banks the percentage is a much lower one. Furthermore, British banks earn less on Governments than banks do here. He doesn't believe there will be much borrowing by business after the war, and the assets of banks in the form of Governments are likely to rise to 80 per cent of the total. In most countries, banks are almost certain to be socialized, but he hopes this may be avoided here.

The meeting adjourned at 12:30 P. M.

The Council reconvened in the Board Room of the Federal Reserve Building, at 12:35 P. M. on December 4, 1944.

All members of the Council were present, except that Mr. Walter S. McLucas represented Mr. Edward E. Brown. The Vice President of the Council, Mr. Charles E. Spencer, Jr., presided.

Goldenweiser. Are we in for inflation immediately after the war? His views have not changed and he still believes the danger not very great but the need of maintaining controls after the war has become more acute. Of course, there always has been the danger of inflation. If, however, the controls are kept up then the danger will pass and we shall have to think chiefly how to find employment for returning soldiers and sailors and dismissed war workers. The question of inflation has become more acute because the war is dragging on and so the demands of people for goods and the means of buying goods are increasing. This will be especially true because the Government will arrange for bonuses and easy credit for returning service men. Furthermore, all other countries want billions of dollars worth of goods from us and thus there will be a great pressure upon our markets. It is not merely necessary to keep up price control but also there must be an allocation of exports and of goods to our own industries. Price control works only up to a certain point; after that there is merely the development of a huge black market. In Europe, black markets have crowded the normal markets completely out of existence. The best thing for us to do is produce as much as possible and maintain allocation; if this not done we may have an inflation spirit which will increase all of our postwar problems. There is a kind of creeping socialization all over the world and the only way to avoid this is to keep the economy on an even keel during the reconversion period. Exports to other countries for some time to come will be largely on a credit basis but in the longer run will be paid for by goods and services. It is possible to conceive of a situation, in the course of the next twenty-five years, where we shall have full employment and will be glad to take imports on a much larger scale than is true at present. It is doubtful whether it would be wise at this time to go very far in the reduction of tariffs but there should be a gradual reduction by means of treaties such as were inaugurated by Mr. Hull. It would be fatal if we refused to lend money at present for the rehabilitation of the world and it must be remembered that we are about the only country that can do this lending on any large scale. As regards interest rates, it is likely that the present rate will become more firmly established and that there will not be any tendency toward lowering of the rate. In the course of

years there probably will be some stiffening of the rate. The amounts that we are likely to lend abroad, while in absolute figures, large, will be relatively small in view of our present debt situation. It always seemed that the circulation of currency would begin to decline when payrolls and production declined but though payrolls and production have declined circulation has continued to increase. The reason for this is probably that so much money is being earned by people who have not had any bank connections and who are, therefore, carrying the money in actual cash.

The meeting adjourned at 1 P. M.

NECESSITY FOR FURNISHING DRAFTS OF BILLS
TO FEDERAL ADVISORY COUNCIL

The Federal Advisory Council at several of its meetings in recent months asked that the Board of Governors furnish to the Council for its information and as a basis of discussion a draft of the holding company bill which it understood had been prepared by the Board. The Council had considered the statement made in the Board's 1943 Annual Report with respect to recommended holding company legislation but stated that without more detailed information it could not discuss the subject with profit. It was also stated on behalf of the Council that it felt that it was legally entitled to information from the Board as to proposed legislation vitally affecting the banking system and that, apart from the question of legality, the Council could not function and could not properly cooperate with the Board unless it were given such information. The Council was advised that the Board would consider the matter at a meeting when all Board members were present. It was suggested in this connection that the question involved was not chiefly a legal one but the much more important one of the Board and the Council understanding each other and working together in the common cause.

The Board has consulted its attorneys with regard to this matter and has been advised that in their opinion the Board is not required to disclose to the Council drafts of proposed bills to which the Board may be giving consideration.

It seems obvious to the Board that the Council does not have the right to call for all information which the Board may have. For example, orders for removal of officers and directors under the provisions of section 30 of the Banking Act of 1933 cannot, because of the specific provisions of the statute, be disclosed to others. Again, the Board is given a discretion in the law with respect to disclosure of examination reports of State member banks. Moreover, there are cases in which it is manifestly inadvisable to permit advance knowledge to reach the public with respect to proposed changes in margin requirements or proposed actions with respect to reserve requirements and similar matters. The mention of these various subjects is sufficient to show that there are certain facts which the Board may not be required to disclose. The Board in the light of all its responsibilities must exercise a sound discretion with reference to the question.

If the Board were required to submit to the Council drafts of legislative bills which it has under consideration, it is entirely possible that the Council would find it advisable to ask the Board to submit to it drafts of all bills, or even drafts of all proposed regulations which the Board might at any time have under study, regardless of the stage of their consideration. This would mean that practically all actions or proposals relating to the general affairs of the System which the Board might wish to consider, through its staff or otherwise, and even in the most tentative way, would have to be furnished to the Council.

Obviously this would greatly impair the freedom of consideration of matters by the Board and make it very difficult for it to operate effectively. This would be especially true in those cases where the Board, as not infrequently happens, is considering proposed legislation or proposed regulations jointly with other agencies of the Government, such as the Treasury or the bank supervisory agencies. It would be necessary that the Council be given drafts of all such proposed legislation or the regulations while still in tentative form. Such a position, taken to its logical conclusion, would even make it necessary for the Board to consult with the Council in each case before replying to the numerous requests which it receives from Congress or the Budget Bureau for its opinion with regard to pending or proposed legislation. Instead of not less than four meetings a year as contemplated by the statute, it would be necessary for the Board to have very frequent, perhaps almost daily, meetings or contacts with the Council. Obviously the law did not so intend and the Board's ability to operate effectively would be seriously impaired.

The Council is not restricted in giving advice or in making recommendations to the Board by its failure to see drafts of bills which the Board has under consideration on any particular subject. The Council is entirely free to formulate and discuss with the Board its own drafts of bills or recommendations on any subject in which it is interested, whether or not the Board is studying the subject. The Council may present such drafts to the Board independently of any drafts of bills or contemplated recommendations which the Board may have under consideration. For this purpose the Council can obtain statistical and factual information that the Board may have available on the subject.

Wholly aside from any legal question involved, the important consideration is to arrive at a reasonable and practical working arrangement between the Council and the Board under which each may properly discharge its responsibilities under the law without in any way affecting the ability of the other to discharge its lawful responsibilities. It is essential that the Board should not be under compulsion to furnish drafts of bills which it has under consideration to the Council or to anyone else if it feels that such action would be incompatible with the proper discharge of its functions or affect its ability to carry out its responsibilities. Furthermore in the nature of the case the Board must itself be the judge of whether there is adequate reason for declining a request of the Council. The Board expects in the future as it has in the past to furnish to the Council any available material which may be requested unless for some good cause it feels that it should not do so. It is essential that the Council and the Board each give recognition to the functions and responsibilities of the other. This the Council should not expect to receive from the Board any material which the Board for good reason feels should not be disclosed, and, on the other hand, the Board, recognizing fully the responsibilities of the Council, should give to it all information which the Council desires whenever there is no sound reason for not doing so. Only in this way can the two bodies work together and accomplish the ends which Congress had in mind in establishing them.

LEGISLATION TO FINANCE BUSINESS IN THE
POSTWAR PERIOD

I would like to review briefly the pertinent facts in connection with legislation now pending for the financing of business during the reconversion and postwar period, especially the bill to authorize Federal Reserve Banks to guarantee loans and the bill to expand the authority of the Smaller War Plants Corporation.

It has long been obvious that Congress would enact legislation to assist small business and particularly to aid in the financing of small business. The only question has been and is what kind of legislation would be enacted. The Smaller War Plants Corporation was created by the Act of June 11, 1942, which passed both houses of Congress without a single dissenting vote. Under this law, the Corporation was given a capital of \$150,000,000 and was authorized until July 1, 1945 to make or participate in loans for war and essential civilian purposes. For some months past various proposals have been before Congress to enlarge and expand the authority of the Corporation.

In this connection, the Baruch Report recommended that the lending authority of the Smaller War Plants Corporation "be extended to permit short-term loans to assist small business in the 'change-over' from war to peace". The Murray Bill (S. 1913), introduced last May, provides \$1,000,000,000 of capital for the Smaller War Plants Corporation and extends its existence until July 1, 1947. It gives to the Chairman of the Corporation, as distinguished from the Corporation itself, broad authority to make or guarantee loans both for reconversion and for peacetime operation. It also would permit the Corporation to make arrangements to provide small business concerns with the benefits of patent rights acquired by the Government or by private individuals and to make available to such concerns engineering and other technical services and educational facilities of the Federal, State, and local Governments.

The bill, H. R. 5125, providing for the disposal of surplus Government property, contains provisions, already approved by the Senate and the House conferees, giving the Smaller War Plants Corporation broad responsibilities with respect to the needs of small business for such surplus property and authorizing the Corporation to purchase surplus property for "resale or other disposition" to small business. For such purposes it authorizes the Smaller War Plants Corporation to make or guarantee loans to small business enterprises in connection with the acquisition, conversion and operation of plants and facilities. Furthermore, it provides that in cooperation with the surplus disposal agencies of the Government, the Corporation may arrange for sales of surplus property to small business concerns on a credit or time basis. This grant of authority is not limited or restricted in any way.

A few weeks ago the Senate, without holding any hearings, took up and, without evidence of any dissenting vote, passed a bill increasing the capital of the Smaller War Plants Corporation from \$150,000,000 to \$350,000,000. The bill is now pending in the House. It is obvious that, because of the broadened authority of the Smaller War Plants Corporation under the Surplus Property Bill, either this measure will be promptly enacted into law or some bill such as the Murray Bill which gives the Corporation \$1,000,000,000 of capital will be passed.

The Smaller War Plants Corporation has been given broad authority in the Contract Settlement Act of 1944, as one of the Government contracting agencies, to provide interim financing in connection with the termination of war contracts. It is not only authorized but directed to make interim loans and guarantees in order to assure that small business concerns receive fair treatment. Moreover, the Director of Contract Settlement is required to collaborate with the Corporation in protecting the interests of smaller war contractors in obtaining expeditious settlement and interim financing.

As further evidence of the support for governmental assistance in the financing of small business, press reports quote Mr. Krug, Acting Chairman of the War Production Board, as saying when he appeared before the Senate War Investigating Committee, that it was even more important to small industries than to big companies to have production controls removed as quickly as possible. Then, in response to a suggestion from Senator Burton that the best thing that could be done for the small business man was to leave him alone, Mr. Krug stated that he thought that was correct except that small businesses must have Government assured loans to tide them over the reconversion period.

Let me turn now to the Wagner-Spence Bill which relates to the authority of the Federal Reserve Banks. When Mr. Baruch came down to Washington last Fall, he requested suggestions from a number of people in the Government, including myself, as to what measures might be recommended with respect to reconversion and postwar policies. After some reflection, I proposed to him the idea which was subsequently incorporated in S. 1918, the pending bill to amend section 13b of the Federal Reserve Act, under which Federal Reserve Banks would be authorized to guarantee loans made by financing institutions to business enterprises. The existing authority for the making of direct loans to business by Federal Reserve Banks would be eliminated from the law. In making this proposal I stated that it was intended merely as a supplementary source of postwar financing and that the most important means should be the use of private funds without any governmental participation. As a result of my suggestions, the Baruch-Hancock Report recommended that, as a permanent source of credit for small and medium size enterprises on a basis of broader risks than banks can be expected to assume, the Federal Reserve System's authority be expanded and liberalized. Although the report recommended a permanent authority, I, myself, have proposed that it be extended only until 1949. I have also

suggested amendments to the bill which would limit the guaranteed portion of any loan to 90 per cent of the amount of the loan and would provide an overall limitation on the amount of outstanding guarantees of four times the amount of the guarantee fund, a maximum of something over \$500,000,000.

The bill introduced by Senator Wagner and Congressman Spence received the endorsement of Mr. Baruch and also of Mr. Hinckley, Director of Contract Settlement, and of the War Department. Mr. Baruch, Mr. Hinckley, and the Secretary of War have all written letters in support of the bill. In addition, the Treasury Department, in a letter from Acting Secretary Bell to Chairman Spence, has interposed no objection to the bill.

While there has been some lack of support for the bill in the Reserve System and, I understand, by one member of the Federal Advisory Council, there has been strong opposition to the bill from some of the bankers, particularly the American Bankers Association. Mr. Walter French, Deputy Manager of the American Bankers Association, has made speeches opposing the legislation. As a result of speeches by Mr. French and Robert M. Haynes, who is Chairman of the Postwar Small Business Credit Commission of the American Bankers Association, the Georgia Bankers Association went on record against the Wagner-Spence Bill, as well as against the Murray Bill and the Taft Bill. The latter two bills are as far removed, in basic principle, from the Wagner-Spence Bill as the poles. The Wagner-Spence Bill was designed to protect the private banking system from Government competition. The other bills specifically provide for direct Government competition. The attitude of the American Bankers Association appears to have been the cause of the distorted and untrue picture of the purposes and provisions of the bill which some of the newspapers have presented in their editorials.

The bill contains no authority whatsoever for Federal Reserve Banks to make direct loans to business. On the contrary, it repeals the authority in the present law under which Federal Reserve Banks may make direct loans. The bill provides only for the guaranteeing of financing institutions against loss on loans to business enterprises and for commitments by the Reserve Banks to take over such loans from financing institutions. I am opposed to Federal Reserve Banks making direct loans to business and industry, and I so stated at the hearings on this bill. Any aspect of competition between the Federal Reserve Banks and commercial banking institutions instead of being created by the bill would be eliminated. The bill would, in fact, enable the private banks, with the assistance of a guarantee, to make loans that otherwise would be made by some Government agency. Whether or not lending banks wish to avail themselves of the guarantees provided by the bill would be entirely optional with them. If they are in a position to make such loans without guarantee, so much the better. Since a bank would have to pay a guarantee fee, it naturally would not ask for a guarantee unless the loan was such that it could not afford to carry the entire risk.

Some of the opposition to the bill has even gone so far as to try to make it appear that the measure provides for socialization of credit. It is aimed at exactly the opposite. It is no more a socialization of credit than was the authority to insure bank loans under the Federal Housing

Administration. That authority encouraged and increased the business of banks in the housing field, and thus eliminated Government competition for such loans.

Before the Wagner-Spence Bill was presented to Congress, I submitted it for comment to the presidents of the Federal Reserve Banks, together with a memorandum explaining the need for such a measure. As I stated at that time, while I did not consider this plan the chief answer to the financial problems of small business, it seemed likely that due to the political appeal of other small business legislation, Congress would provide some additional governmental mechanism for small business financing during the reconversion period and thereafter. I referred to the Taft Bill, the Mead Bill, and the Murray Bill. I further stated that we cannot expect members of Congress to resist politically appealing measures of this kind unless they have an acceptable alternative at hand. While I sympathize with the desire of the American Bankers Association to have the banks stand on their own feet, it is unrealistic to expect to beat something with nothing.

While representatives of the ABA, as well as some of the bankers, have been openly or covertly opposing the Wagner-Spence Bill, which provides no competition with banks, Congress has actually passed, with no evidence of opposition from the bankers, legislation directing the Smaller War Plants Corporation to provide interim financing on terminated war contracts, the Senate has passed a bill authorizing an increase of \$200,000,000 in its capital, and the Surplus Property Bill gives the Corporation broad authority to make loans directly in peacetime competition with banks.

By trying to kill off a measure that would protect and safeguard the banks while at the same time doing nothing to head off legislation, already approved, steadily expanding the powers and authority of a directly competitive Government agency, the opponents of the Wagner-Spence Bill have, in my opinion, done a disservice to the private banking system. No one, if I may say so, has more consistently opposed than I have the encroachment of Government lending agencies upon what to my mind should be the province of the banks. In the decade I have been in Washington I have by every means within my power opposed efforts of the Home Loan Bank System, of the RACC, and other governmental agencies, whether in the agricultural field or elsewhere, to invade the realm of private banking. And I have as persistently, in FRA financing, in recommending legislation on agricultural loans, in war financing operations under the so-called V, VT and now the T loans, as well as in the Wagner-Spence Bill, advocated the insurance or guarantee principle in order to facilitate the flow of private credit and thus avoid the need for public funds disbursed by competitive Federal agencies.

Not only would failure to pass the Wagner-Spence Bill help to insure passage of some measure embodying exactly the opposite principle, but it will tend to accentuate an already acute situation. Rather than have Government agencies make direct loans with money borrowed from the banks, it would be much better to have the banks make guaranteed loans, because in one case the banks are living on interest on Government bonds while in the other they are getting income from their own loans, and are merely relying

upon a guarantee. The latter is far less subject to criticism and political attack. For instance, the banks hold billions of mortgages guaranteed under FHA and no one would think of criticizing that, even though it is more profitable to the banks than investing in Government bonds. The banks may well be subject to attack, however, because of the fact that they are getting about half of their gross income today from Government securities, without which they would actually be in the red by more than \$200,000,000, but with which their net profits, after taxes, are more than 9 per cent on their capital accounts.

I mention this in passing in order to round out the picture of the situation as I view it with respect to the pending measures on reconversion and postwar financing.