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The Federal Reserve System in Wartime

THE MAJOR OBJECTIVE of Federal Reserve policy while the war continues is to assist the government in financing the war effort. The character and size of the Reserve System's task in war finance is primarily determined by the scale of the government's spending program and by the extent to which this expenditure is covered by taxes and by sales of United States securities to nonbank investors. The magnitude of the undertaking confronting the System is indicated by the figures presented in Table 1, which are based on the current records and budget estimates of federal expenditures and public debt increases, coupled with data and estimates showing the participation of the banking system in financing the federal debt.

Commercial bank participation in the government's financing program during the coming months of war is necessarily highly conjectural. However, it is widely assumed that the banks will continue to make substantial additions to their government security portfolios. It is estimated that even with considerable success in selling government security offerings outside the banking system, total bank holdings of federal debt will range from $95 billion to $107 billion by the end of June 1945.

FUNCTIONS OF THE FEDERAL RESERVE SYSTEM IN WARTIME

For the duration of the war the Federal Reserve officials will presumably endeavor within the limits of their powers to keep government borrowing from commercial banks at the lowest level compatible with prompt and adequate provision of the funds required for war purposes. Although the character of the government's taxing and borrowing program is not a responsibility of the Federal Reserve officials, they conduct research on problems connected with the program and offer suggestions to the Congress and to the Treasury that may affect the decisions finally made. When the

government's war financing program has assumed definite form the Federal Reserve officials are obliged to cooperate in carrying it out. This undertaking involves full banking support for Treasury borrowing operations; it entails facilitation of the flow of bank credit into war production channels and restriction of its employment in nonwar uses; and it necessitates greatly expanded fiscal services for the Treasury and other government agencies.

TABLE 1 — FEDERAL EXPENDITURES, INCREASE IN THE FEDERAL DEBT, AND CHANGES IN BANKING SYSTEM'S HOLDINGS OF FEDERAL OBLIGATIONS, FISCAL YEARS, 1941-45
(dollar figures in billions)

	FISCAL YEARS ENDING JUNE 30				
		Reported			*Estimated*
	1941	1942	1943	1944	1945
Federal expenditures [a]	$13	$32	$80	$95	$100[b]
Increase in federal debt	6	22	64	62	50[b]
Total interest-bearing debt outstanding, direct and fully guaranteed	55	77	141	203	253
Increase in banking system's holdings of federal obligations [c]	3	7	31	23	12-24[d]
Total holdings of federal obligations by banking system	22	29	60	83	95-107[d]
Increase in banking system's holdings of federal debt as percentage of the net increase in federal debt	54%	29%	48%	37%	24-48%[d]

Source: *Federal Reserve Bulletins* and Statement of the Director of the Bureau of the Budget, August 1944.

[a] Government expenditures plus net expenditures by government corporations and agencies.

[b] Estimates based on the Statement of the Director of the Bureau of the Budget, August 1944.

[c] All commercial banks and the Federal Reserve Banks.

[d] Range estimates by the author, conservative and liberal.

PROVISION OF RESERVES AND CURRENCY

Most important of the functions of the Federal Reserve Banks while war is in progress is to provide commercial banks with adequate reserves. These reserves serve to finance their purchases of government securities, to support possible loan expansion, and

to compensate for the wartime expansion of currency in circulation.

The greater proportion of the funds acquired by the government from sales of its obligations to commercial banks remains in the banking system in the form of deposits, although these deposits are shifted from bank to bank as disbursements are made. In other words, commercial bank purchases of government securities generate means of payment in the form of demand deposits subject to check. The Federal Reserve Banks hold the legal reserves of member banks, and the member banks in turn hold a substantial part of the reserves of nonmember banks as well as most of the commercial bank deposits of the country, which constitute the chief means of payment. In this way the Federal Reserve Banks are actively assisting in the wartime expansion of commercial bank deposits.

An extraordinarily large wartime demand for currency also has to be met. To satisfy that demand, member banks obtain currency by drawing against their deposit balances with the Federal Reserve Banks, by selling acceptable assets to the Federal Reserve Banks (e.g., Treasury bills), or by borrowing from them.

The Federal Reserve Banks can expand credit within the limits set by the reserve requirements of 40 percent gold against notes and 35 percent lawful money against deposits. These limitations are not rigid, as reserve requirements may be suspended under the emergency powers of the Board of Governors. Moreover, increased demands for currency could be met in part by issuing Federal Reserve Bank notes requiring no gold cover. Relief might also come through Treasury action to increase its own currency issues, by monetization of the gold held by the exchange stabilization fund, by issuance of additional silver certificates against free silver bullion, or by the issue of United States notes as provided under existing statutory powers. Finally, legislation might be passed lowering or eliminating gold reserve requirements against Federal Reserve notes in circulation. Although the reserve ratios of the Federal Reserve Banks were still considerably above the statutory minima at the end of June 1944, the ratio has been moving downward since our entry into the war and remedial action of some sort may become necessary. In World War I following this country's entry into the war, the reserve ratios of the Reserve Banks similarly declined, and the Federal Reserve Banks were required to husband

their gold in order to sustain the expansion of bank credit.[1]

Until the end of 1940 the inflow of gold was more than sufficient to offset the outflow of currency into circulation and to furnish the larger reserves required to support a growing volume of deposits. But by the early part of 1941 gold shipments had virtually ceased, as indicated by Chart 1, further acquisitions being confined largely to new production, while gold buying for the account of foreign central banks and governments began to make inroads on gold stocks. Between October 1941—when they reached a peak—and June 30, 1944, gold stocks declined $1.6 billion. (See Chart 1.) The actual loss of gold to foreign countries has been somewhat in excess of the decline in gold stocks since stocks were augmented during this period through domestic production. The leveling off and subsequent decline of gold holdings were accompanied by a continued rise in deposits and currency in circulation. The result was a rapid decline in excess reserves shown in Chart 2, which was felt most sharply in New York where banks were losing funds to the rest of the country. Finally, in April 1942 the Federal Reserve Banks

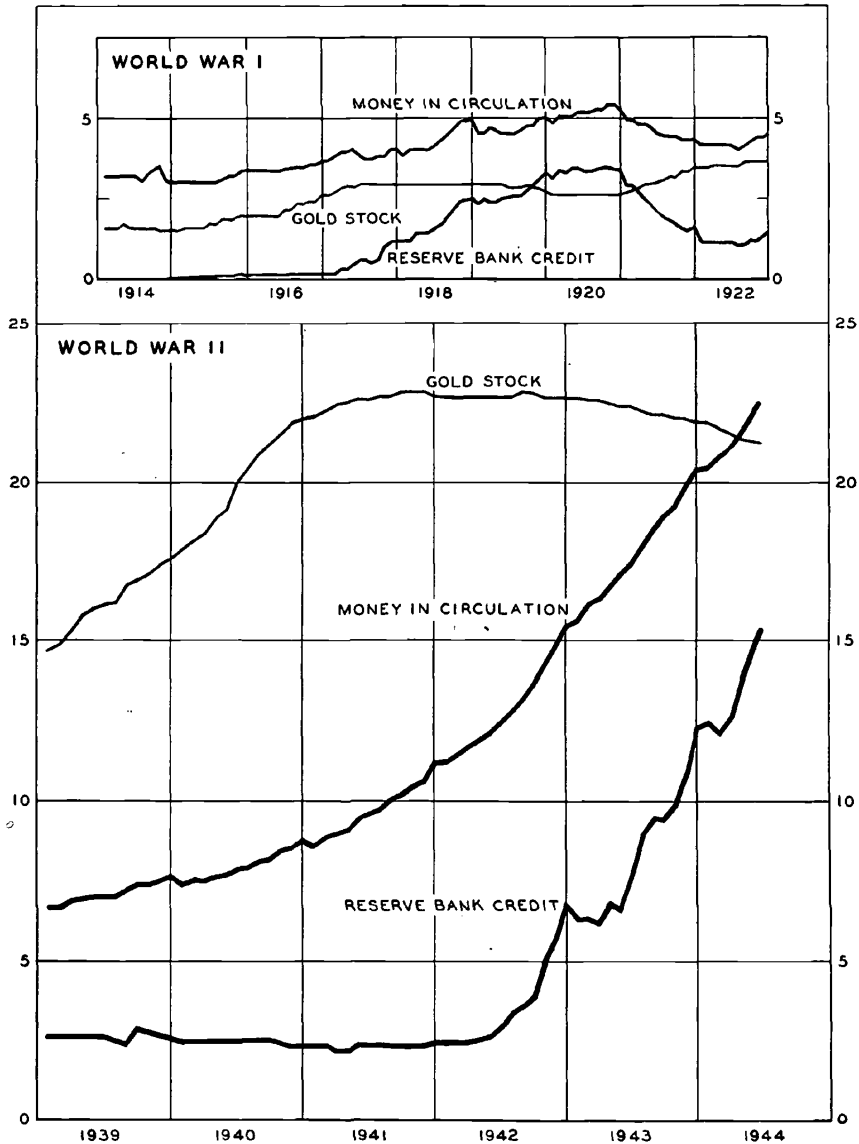
[1] Changes in the ratio of total reserves of Federal Reserve Banks to deposit and Federal Reserve note liabilities combined during World Wars I and II compare as follows:

World War I		*World War II*	
December 31, 1915	94.1%[a]	August 31, 1939	86.9%
December 31, 1916	81.4[a]	December 31, 1939	86.7
April (5-6) 1917	84.7	December 31, 1940	90.8
December 28, 1917	63.6	December 31, 1941	90.8
December 27, 1918	50.6	December 31, 1942	76.3
June 27, 1919	52.1	December 31, 1943	62.6
		June 30, 1944	56.3

[a] The reserve percentages prior to 1917 are not strictly comparable with those of later years. Net deposits of the Federal Reserve Banks were used as the basis of the calculations in 1915 and 1916; thereafter, total deposits were used.

The Federal Reserve Act of 1914 by lowering reserve requirements of member banks gave the newly established System a strong leverage position, since the provision of a small addition to the reserves of member banks could support a larger volume of deposits than formerly. Many state legislatures followed suit in lowering reserve requirements and this strengthened the reserve position of the Federal Reserve Banks. Another change in reserve requirements of member banks was made in 1917, and was coupled with a provision requiring that total legal reserves be deposited with the Federal Reserve Banks. The conditions of membership for state banks were also made more attractive and a number of large state banks joined the System during the period. These developments increased the gold stock at the disposal of the Federal Reserve Banks, and to make this gold go further the Federal Reserve Banks frequently borrowed from one another.

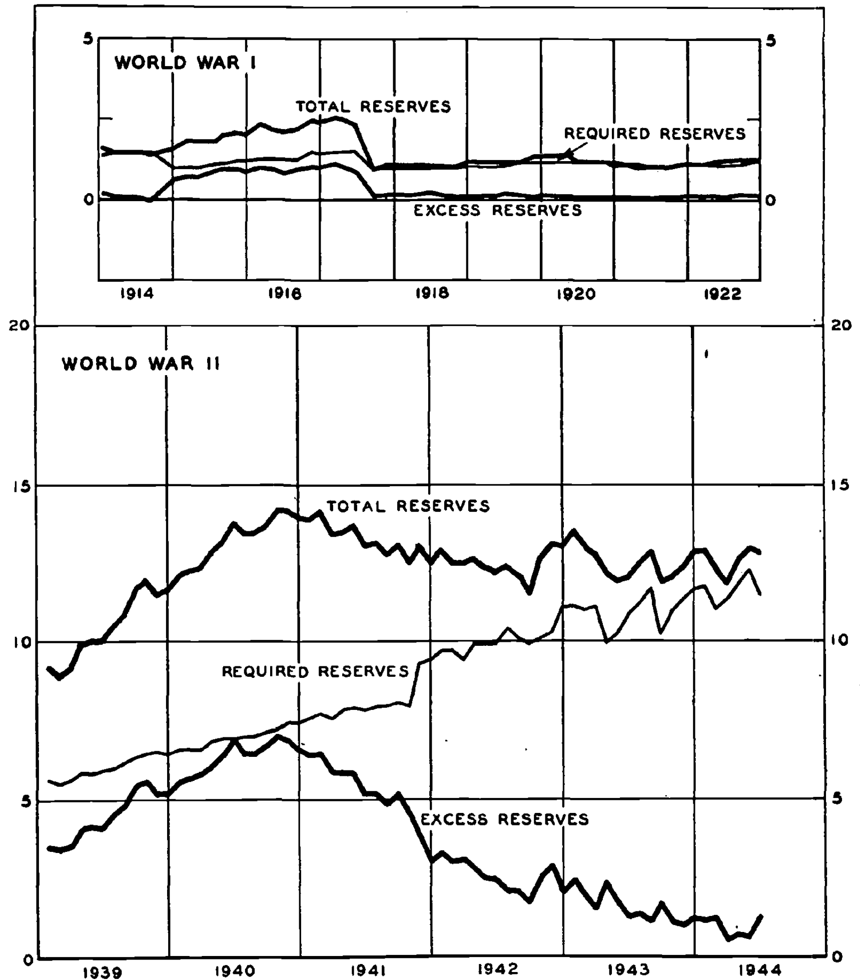
CHART I – GOLD STOCK, MONEY IN CIRCULATION AND RESERVE BANK CREDIT, WORLD WARS I AND II
(in billions of dollars)



Source: World War I, Board of Governors of the Federal Reserve System, *Banking Studies* (1941) and *Banking and Monetary Statistics* (1944). World War II, *Federal Reserve Bulletins.*

began to provide funds to the commercial banks through their credit operations and subsequently supplied them at a rapid rate. The growth of currency in circulation from the end of 1941 to June 30, 1944 absorbed $11.3 billion of the $12.9 billion of additional credit provided by the Federal Reserve Banks in this period.

CHART 2 – Member Bank Reserve Balances,[a] World Wars I and II (in billions of dollars)



Source: World War I, Board of Governors of the Federal Reserve System, *Banking Studies* (1941) and *Banking and Monetary Statistics* (1944). World War II, *Federal Reserve Bulletins.*

a World War I, national banks only.

Reserve balances of member banks have remained relatively steady since the middle of 1940: they amounted to $12.5 billion on December 31, 1941, $13.1 billion on December 31, 1942, and stood at $12.9 on December 31, 1943, and on June 30, 1944. In contrast to this situation, excess reserves declined steadily over the same four-year period.

Events in World War I took a somewhat comparable course. A large gold inflow occurred before our entry into the war and built up excess banking reserves, as depicted by the insert panel on Chart 2. Revision of reserve requirements and wartime expansion of deposits and currency in circulation imposed a strain on commercial bank reserves. Consequently, a large amount of Federal Reserve credit had to be extended to reduce this pressure. The sharp decline in member bank excess reserves in 1917, shown in the insert panel, resulted from an amendment of the Federal Reserve Act which re-defined legal reserves to include only balances held with the Federal Reserve Banks, but lowered the total reserve requirement.

STABILIZATION OF GOVERNMENT SECURITIES MARKET

Another function of the Federal Reserve System that has been extremely important since the outbreak of World War II is the stabilization of the market for government securities. For some years before the war the Federal Reserve officials accepted responsibility for maintaining "orderly conditions" in the government bond market. In 1938, this policy was supplemented by an agreement of the Federal Reserve and other bank supervisory agencies to value, for examination purposes, investment bonds at book or cost less amortization, whichever is lower. Under such an arrangement, a decline in the market value of government or other securities would not produce a shrinkage in the appraised value of bank investments and thus would not precipitate "distress sales" by banks.

In 1939 after war broke out in Europe, the Federal Reserve Banks made large-scale purchases of government bonds in the open market in fulfillment of the commitment to maintain "orderly conditions." Between August 28 and September 25 when purchases ceased, the Federal Reserve Banks acquired $473 million of government securities.[2] Thereafter recovery in market values was rapid and some

[2] Board of Governors of the Federal Seserve System, *Annual Report, 1939,* p. 7.

of these acquisitions were disposed of before the end of the year. In undertaking these open market operations the Board of Governors indicated that it and the Reserve Banks recognized "a measure of responsibility for safeguarding the large United States Government portfolio of the member banks from unnecessarily wide and violent fluctuations in price." It added emphatically, however, that "The System cannot and does not guarantee any current prices of government obligations nor does it undertake to preserve for member banks such profits as they may have on their Government securities, or to protect them against losses in this account."[3] However, in December 1941 immediately following our entry into the war the Board took a more positive attitude toward stabilization, announcing that it would "exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government's requirements." This somewhat ambiguous declaration was another step in the direction of stabilization of the government bond market on the basis of the existing pattern of interest rates. In the course of 1942 more definite commitments with respect to the bond market were made.

At the end of April 1942 a discount rate of 3/8 of 1 percent per annum was established by the Open Market Committee for all Treasury bills that might be offered to the Federal Reserve Banks. This measure was supplemented in August by instructions to the banks to give to sellers of bills, if desired, an option to repurchase at the same rate a like amount of bills of the same maturity.

With regard to other rates, it was stated that "the policy of the Treasury and of the Federal Reserve System has been directed towards the stabilization of prices and yields of marketable securities. Investors in nonmarketable securities know in advance the prices at which they will be able to redeem their securities on any future date that they may find it necessary to do so. Investors in marketable securities know that prices and yields are stabilized and that they will obtain no higher yields by deferring purchases to a future date."[4] Under this stabilized structure of interest rates

[3] *Ibid.*, p. 5.

[4] *Federal Reserve Bulletin* (February 1943) p. 114. Commenting upon the application of this policy during 1943, the Board of Governors declared in its *Annual Report* (p. 12) for that year: "It maintained stable conditions in the United States Government security market and kept prices and yields within a pattern agreed upon with

3-month Treasury bills have carried a rate of 3/8 percent; 1-year certificates of indebtedness, 7/8 percent; 10-year issues, 2 percent; and the longest-term offerings 2½ percent.

In the latter part of 1942 the Treasury let it be known that all new issues available for purchase by commercial banks would come within a 10-year maturity limit; it was also indicated that the maximum rate of interest on securities sold to commercial banks would be 2 percent. In October 1942, Daniel W. Bell, Under Secretary of the Treasury, stated: "It seems reasonable that the interest rate on securities financed in this manner (i.e., securities bought by commercial banks) should be kept down to a maximum of 2 percent, regardless of the maturities involved, because the costs incurred by the banks in making loans direct to the government and in handling the increased deposits resulting from these loans are small."[5]

This policy was somewhat modified in the Fourth War Loan when commercial banks were permitted to subscribe to the 2¼ and 2½ percent bonds and to Series F and G savings bonds in amounts not over 10 percent of their savings deposits but not exceeding $200,000 in the aggregate. Banks could not, however, hold more than $100,000 of the savings bonds. Permission to purchase longer-term bonds and to acquire Series F and G savings bonds was given to the commercial banks in the Fifth Loan Drive also. Limitations on the aggregate amount of savings bonds that a bank might hold remained unchanged but total purchases of bonds and savings bonds, including those purchased during the Fourth Drive, were raised to 20 percent of savings deposits but not to exceed $400,000 in the aggregate.

INFLUENCING THE VOLUME OF BANK CREDIT IN SELECTED USES BY SPECIAL REGULATION AND SUPERVISION

The Federal Reserve officials not only facilitate the expansion of bank credit in wartime but they endeavor to see that such credit is used to further the war effort. In accordance with this policy they have fostered bank financing of production in war industries and used their influence to reduce certain types of nonessential

the Treasury. This policy facilitated the sale of securities by removing all incentive for delaying investment and by encouraging purchasers to hold the securities they had acquired."

[5] Address to the Investment Bankers Association of America.

procedure, cancellation is followed by freezing of loans made to finance such contracts until ten days after payments have been received under contracts. The borrower, moreover, need not make any payments of interest or principal on the suspended portion of the loan. Meanwhile, the guarantor will pay interest up to 2½ percent on the suspended loan if the loan continues to be held by a bank. Thus both borrower and lender are protected during the period following cancellation of contracts until payment is made.

At first the suspension provisions of Regulation V applied only to loans outstanding, thus giving the borrower an incentive to use funds continuously and to the full amount consistent with production under war contracts. Then in case of a cessation of hostilities less working capital would be tied up and cash on hand could be used for any purpose desired. The added interest cost on the portion of the loan in use that was not needed was paid to insure availability of these funds in case of sudden termination of contracts.

Many firms unable to obtain V loans because of their strong credit position were faced with the problem of obtaining unguaranteed bank loans to finance war contracts, and in the event of cancellation, to meet interest charges on such loans regardless of delays in settlement of contract. As a result an increasing number of contractors became reluctant to accept more war orders. Hence modifications were made in Regulation V loans in September 1943 to enable war contractors and subcontractors to arrange lines of credit in advance of need as an assurance that working capital would not be frozen in event of contract termination.[10] The modified broader plan—the VT loans—enabled "contractors to obtain the use of most of their own working capital immediately upon termination of their contracts." Contractors and subcontractors follow the same procedure in obtaining VT loans as V loans, with two exceptions. If the loan is intended to free the borrower's own working capital, the lending bank must at all times have a participation in the loan. Accordingly, the original percentage of guarantee specified in the agreement is not increased by contract cancellations. The lending bank must also share with the government any commitment fee which may not exceed ½ of 1 percent

10 "Broadened Basis for Regulation V Loans," *Federal Reserve Bulletin* (September 1943) pp. 849-50; also Roy A. Foulke, "Government Financing of War Contractors," *Dun's Review*, Part II (July 1944) p. 28.

per annum on the undisbursed portion of the credit.

As in the case of V loans, VT loans carry guarantees of the War or Navy Departments, while the Federal Reserve Banks act as fiscal agents. However, VT loans do not fully protect commercial banks against loss. Hence some contractors in a weak position have been forced to rely wholly upon V loans under modified borrowing formulas applying both to canceled and uncanceled contracts.

Loans guaranteed under Regulation V accounted for almost half the total estimated increase in loans made for war production purposes during 1942. In 1943 the volume of guaranteed loans outstanding increased rapidly, rising from $804 million at the beginning of the year to $1.9 billion by the end of December[11] and to $2.1 billion by June 30, 1944. Even more significant is the rise, from $2.7 billion at the beginning of 1943 to $8 billion on June 30, 1944, in the volume of funds authorized to be made available to borrowers under guarantee agreements. Approximately half the number of loans made under Regulation V through 1943 were for $100,000 or less, while loans of $25 million or over constituted about one half of the dollar amount.[12]

Since V and VT loans have to be arranged prior to cancellation of contracts, the need for guaranteed loans to be negotiated subsequent to termination of contracts was recognized in the Baruch-Hancock report on War and Postwar Adjustment Policies. In line with the recommendations of that report the Contract Termination Act of June 1944 provided for T loans available to any war contractor who "is or has been engaged in performing any operation deemed . . . to be connected with or related to war production." The act sets up an Office of Contract Settlement headed by a Director who is empowered to determine the procedure to be followed by the War Department, Navy Department and Maritime Commission in guaranteeing termination loans. The Federal Reserve Banks serve solely as fiscal agents, as they do for V and VT loans. Under General Regulation No. 1 issued August 18, 1944, by the Director of Contract Settlement, contracting agencies are instructed to delegate authority to the Reserve Banks to approve applications for guarantees of loans after consultation with representatives of such agencies. If there are no representatives available, necessary

11 Includes VT loans in the late months of the year.

12 Board of Governors of the Federal Reserve System, *Annual Report, 1943*, pp. 20-21.

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There was considerable criticism of the lack of standardization of V and VT loans and the delays encountered in qualifying for them. Procedures for obtaining T loans were accordingly simplified with a view to making such loans more readily available to contractors.

Regulation W—Consumer Credit

Besides encouraging the extension of credit for war production, the Federal Reserve officials took steps even before the United States entered the war to reduce the volume of consumer credit. In September 1941 while the country was still in the defense stages of war preparation, the Federal Reserve Board of Governors, acting under the authority of an executive order, put into effect Regulation W. This regulation was one means of helping to limit the demand for commodities to those market supplies which were available, and of slowing the pace of the wartime inflationary movement.[13] Originally applicable only to instalment sales and loans repayable in instalments, the regulation was subsequently extended to include charge accounts and single payment loans. The restrictions cover consumer credits, whether extended by commercial banks or by other organizations.

Controls were applied to consumer credit by shortening the period of repayment and by raising the percentage of down payments required on commodity instalment purchase loans.[14] Interest charges, however, were not used as a means of control. This was because they constitute a relatively unimportant part of the total operating costs of specialized consumer financing agencies, are an even smaller part of the total monthly payment by consumer instalment borrowers, and are absorbed in charge account credit as a cost of selling goods.

Regulation W is of course only one of the factors responsible for the reduction of consumer debt during the war. The rise in individual incomes has facilitated repayment of outstanding debt, and has enabled more people to pay cash for purchases. Together with the

[13] Board of Governors of the Federal Reserve System, *Annual Report, 1941,* p. 58.

[14] See Gottfried Haberler, *Consumer Instalment Credit and Economic Fluctuations* (National Bureau of Economic Research, Financial Research Program, 1942) pp. 161-62.

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[14] See Gottfried Haberler, *Consumer Instalment Credit and Economic Fluctuations* (National Bureau of Economic Research, Financial Research Program, 1942) pp. 161-62.

scarcity of goods customarily bought on the instalment plan, this rise has also greatly contracted the need and demand for consumer credit.

At the close of 1941 total consumer credit outstanding amounted to $9.5 billion and by June 30, 1944 it had fallen to approximately $5.0 billion; most of this reduction was accounted for by the decline of instàlment credit.

Supervision and Examination

The supervisory and examining functions of the Federal Reserve officials provide a means of influencing to a moderate extent the amount of credit in selected areas, and the war necessity has pointed the way to a more effective employment of bank examination as a supplementary control instrumentality. In addition bank supervision and examination have been relied upon to influence bank investment in, and lending on, government securities.

On May 7, 1942, all of the federal bank supervisory agencies joined in urging lenders to accelerate the repayment of outstanding loans made for nonproductive purposes. In addition, examiners were asked "to pay particular attention in the course of their examinations to individual debt to determine whether it is being reduced and to the circumstances which may be preventing its reduction or preventing it being put on an amortization basis."[15] Again on June 17, 1942, all banks and other financial institutions were urged to cooperate through credit policy in discouraging the unnecessary accumulation of inventories of consumer goods. Examiners of the Federal Reserve Banks, of the Comptroller of the Currency and of the Federal Deposit Insurance Corporation were instructed to ascertain the extent to which banks were complying with this suggestion and to discuss the urgency of reducing nonproductive credit with the appropriate bank officers.[16]

Adjustments and revisions of the supervisory standards of the Federal Reserve System and other examining authorities have been necessary to facilitate commercial bank participation in the wartime government security market. The increase in deposit liabilities resulting from this participation has not been accompanied by proportionate increases in bank capital accounts, a fact that caused the

[15] Board of Governors of the Federal Reserve System, *Annual Report, 1942*, p. 112.

[16] *Ibid.*, pp. 113-14.

Federal Reserve officials and other bank supervisory agencies to modify their traditional rule-of-thumb standard of a 10 to 1 ratio of deposits to bank capital. They announced (November 1942) that there would be no deterrents in examination or supervisory policy to investments by banks in government securities of all types eligible for bank purchases, and that banks would not be criticized for utilizing their idle funds as far as possible in making such investments. The banks were also advised that loans to customers for the purpose of buying government securities would not be criticized by examiners provided the loans were fully repayable within six months.[17]

The significance of the capital to deposit ratio has clearly been altered by the increase in deposits resulting from bank investment in government securities, which are generally regarded as riskless assets. Moreover, increases in bank reserves have added to the protection afforded depositors in recent years.[18] If cash, reserves, amounts due from banks, and government securities are eliminated, the ratio of capital to the remaining assets of member banks is higher now than it was when we entered the war.[19]

As the borrowing program has expanded some modifications of these supervisory policies have been required. Examining authorities have found it expedient to qualify their November 1942 announcement by cautioning individual banks whose deposits have grown most rapidly against an unbalanced investment policy in government securities.

In order to assure the distribution of new issues, the Treasury offers its securities at prices slightly below those that the market

17 *Ibid.*, p. 21.

18 Federal Deposit Insurance Corporation, *Annual Report, 1942;* and Board of Governors of the Federal Reserve System, *Annual Report, 1943,* p. 30. "Increases in banks' capital accounts in recent years have been much smaller, relatively, than increases in bank liabilities. There is, in other words, less margin for the protection of the general depositors, if the nature of bank assets is disregarded. But most of the increase in liabilities has been accompanied by growth in assets involving no risk of loss and the ratio of capital accounts to what are sometimes termed 'risk assets' (all assets other than cash, reserves, due from banks and Government securities) is higher now than it was at the beginning of the war. On December 31, 1943, this ratio for all member banks as a group was 29 percent compared with 23 percent on December 31, 1941."

19 The subject is treated more extensively in C. R. Whittlesey's, *Bank Liquidity and the War* (National Bureau of Economic Research, Financial Research Program, ms. 1944).

(particularly the banks) is willing to pay. As a result the use of bank credit for speculation in government securities tends to be encouraged. It has been further encouraged by the stabilization of the structure of prices and interest rates on government obligations and by prohibiting banks from subscribing to new Treasury offerings, except in limited amounts. Consequently, banks have been urged to restrict their loans on government issues to bona fide investors. The increase in loans on securities by weekly reporting member banks throughout the country was about $700 million during the First War Loan Drive, approximately $1.3 billion in the Second Drive, more than $1.8 billion in the Third, $1.1 billion in the Fourth, while the Fifth Loan Drive topped all the preceding figures. Between May 31 and July 12, 1944 weekly reporting member banks' loans on government securities increased about $1.9 billion, $600 million of which consisted of loans to security brokers and dealers.

The large volume of bank credit used to finance security purchases attracted unfavorable notice during the Third Loan Drive, when it first became evident that a large proportion of the loans was speculative in character.[20] Hence, in their preparation for the Fourth Loan Drive, the Federal Reserve officials urged commercial banks to confine loans on government securities to legitimate credit needs of dealers and investors. The consequent voluntary rationing of bank credits, and the fact that anticipated gains from speculative purchases during the Third Loan Drive failed to materialize, accounted for a sharp reduction in bank borrowing during the Fourth War Loan Drive.

Again during the Fifth Drive some of the loans were suspected of being speculative and were subjected to criticism. The *Federal Reserve Bulletin* stated: "It seems likely that . . . a considerable amount of loans made during the recent drive were obtained with

[20] The Federal Reserve Bank of New York, *Annual Report, 1943*, p. 29, states: "bank financing of speculative subscriptions to Government securities was opposed, and the President of this bank, on September 1, addressed a letter to all banks in the District urging them . . . to discourage speculative subscriptions to War Loans securities."

Federal Reserve Bulletin (November 1943) p. 1057; and the Federal Reserve Bank of New York, *Monthly Review* (December 1, 1943): "Some part of the Government securities purchased by the banks appears to have been supplied as a result of the practice of free-riding. In other words, speculators have obtained allotments of Government securities and later resold them to obtain profit from the premiums commanded by the new issues after the closing of the books for the receipt of subscriptions."

the view to subsequent sale of the securities. Such loans are in contravention of the request made by the Treasury before the drive. It seems also that in some cases subscriptions have been made by nonbank purchasers with an understanding that the banks would subsequently take over the securities. This is contrary to the objective of the drive which is to sell securities to nonbank purchasers who intend to hold them as investments."[21]

FISCAL AND OTHER FUNCTIONS

Although the Federal Reserve officials are primarily concerned during the war period with problems of raising funds for the government, they also serve as fiscal agents for the Treasury and for such government agencies as the Reconstruction Finance Corporation, its subsidiaries, and the Commodity Credit Corporation. Until 1943, Federal Reserve officials assisted the Treasury in organizing sales of federal obligations to nonbank investors. In addition, the Federal Reserve Banks disbursed funds to pay for commodities bought by these agencies for the procurement and stock-piling of strategic and critical materials, and for the expansion of production facilities for the manufacture of war materiel. When requested they hold warehouse receipts and maintain inventory records for government purchasing agents. They also handle the very considerable disbursements of allied belligerent governments for war supplies.

The requirements of the war have increased tremendously the volume of work the Federal Reserve Banks have been called upon to undertake as fiscal agents for the Treasury, and operations connected with the distribution, exchange and redemption of public debt obligations have grown by leaps and bounds. Many millions of checks drawn by disbursing officers are handled by the Federal Reserve Banks. Other millions of checks received in payment of taxes and customs are deposited with the Federal Reserve Banks and credited to the general account of the Treasury. At the close of 1943, about 12,400 officers and employees, or approximately 50 percent of the entire personnel of the Banks, were doing various kinds of work for other government departments and agencies. By comparison not quite 4,000 employees, or roughly 30 percent of the total personnel were similarly engaged at the end of 1941.[22]

21 *Federal Reserve Bulletin* (August 1944) p. 746.

22 Board of Governors of the Federal Reserve System, *Annual Reports, 1941* and *1943*.

The Federal Reserve Banks cooperate, too, with the agencies conducting economic warfare, by administering the Foreign Funds Control under general authorization from the Treasury. This involves control of all transactions affecting the "nationals" of blocked countries, as well as the control of all imports of dollar currency into the United States. Another activity, initiated early in 1942 at the request of the Treasury, is the administration by the Federal Reserve Bank of San Francisco of the property of evacuated Japanese in the Twelfth District. Finally, the Federal Reserve Board of Governors and the Reserve Banks collaborate with other government agencies in research activities pertinent to the war effort and to the solution of postwar problems.

These varied fiscal, depository, custodial and collaborative research functions become especially important in wartime because of the rapid expansion of the government's spending, borrowing, lending and taxing activities. They do not involve decisions as to credit policy, but they do emphasize the subordination in wartime of the Federal Reserve Banks' role as bankers' banks to their role as bankers to the government. Moreover, these numerous and varied functions effect closer working contacts between the Reserve Banks and other public agencies, and should help to bring about a more consistent and better coordinated plan of fiscal and credit operations.

WARTIME PROBLEMS OF PROVIDING MEMBER BANK RESERVES

The key policy problem of the Federal Reserve authorities in aiding the war financing program is the selection of the method to be followed in supplying member banks with reserves needed to finance their purchases of government securities and to meet the wartime growth of currency in circulation. There are a number of methods that may be used to meet this problem, and in making their choice the officials must not only deal with the immediate situation but must make provision for future developments. Consequently, the method adopted must establish a position that gives the utmost latitude for changes in policy when circumstances warrant such changes. In addition to monetary expansion, particular attention