A meeting of the executive committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, April 1, 1947, at 10:10 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Draper
Mr. Vardaman
Mr. Davis

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Smead, Director of the Division of Bank Operations of the Board of Governors
Messrs. Musgrave, Chief, and Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Chairman Eccles stated that Senator Tobey, Chairman of the Senate Banking and Currency Committee, called on the telephone yesterday and said that he understood that Senator Taft was planning vigorously to oppose the passage of the bill extending for a further period the existing authority of the Federal Reserve Banks to purchase securities directly from the Treasury, and inquired whether the Board felt that, as Chairman of the Banking and Currency Committee, Senator Tobey should press to have the bill brought up and passed. Chairman Eccles also said that, while the existing authority expired yesterday, he told Senator Tobey that he did not think it made a great deal of difference whether the bill was passed now or at any reasonable time in the future and that it might be better if he did not press for passage at this time. The Chairman went on to say that he tried to ascertain Senator Taft's attitude on the bill, but had not been able to reach him.

> Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee on February 27 and March 1, 1947, were approved.

On March 13, 1947, in order to increase the authority of the Federal Reserve Bank of New York to sell and redeem securities for the System open market account, the members of the executive committee approved an increase from $500 million to $750 million in the limitation contained in the first paragraph of the direction issued by the executive committee at the meeting on March 1, 1947, and on March 20, for the same reason, the limitation was further increased from $750 million to $1,250 million.

> Upon motion duly made and seconded, and by unanimous vote, the actions of the members of the executive committee on March 13 and 20, 1947, were approved, ratified, and confirmed.

Mr. Rouse then submitted a report prepared at the Federal Reserve Bank of New York of open market operations for the period from

February 28 to March 31, 1947, inclusive, and he read a review of conditions in the Government security market during March.

> At the conclusion of a discussion, upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period from February 28 to March 31, 1947, inclusive, were approved, ratified, and confirmed.

Before this meeting members of the executive committee had received copies of a memorandum prepared by Mr. Musgrave under date of March 26, 1947, giving revised estimates of the Treasury's cash position for the remainder of the fiscal year and discussing the effect on bank reserves of Treasury operations during that period. In a discussion of the figures presented by the memorandum, Chairman Eccles expressed the opinion that, inasmuch as there were no certificates maturing on May 1 and in view of the increased reserves that had been placed in the market and which would be returned to the market by the retirement on April 1 of approximately $1,500 million of Treasury certificates, it would be desirable to retire at least $100 million of bills each week during the month of April, and perhaps through the months of May and June, making a total retirement of $1,300 million. In a discussion of this suggestion, Chairman Eccles added that, in view of easy conditions in the money market which might otherwise exist during April, it might be desirable to retire as much as $200 million of bills each week during the next four weeks and possibly $100 million a week in May and

June, making a total of $1,600 million for the period, which, if $1 billion of the June maturity of certificates were retired, would leave a Treasury balance at the end of June of approximately $2,200 million. There was general agreement with this suggestion.

The discussion then turned to the form of the recommendation to be included in the letter that might be sent to the Treasury with respect to further debt retirement, and it was agreed unanimously that a draft of letter would be prepared along the lines of the discussion, which would be sent to the Treasury upon approval by Messrs. Eccles and Sproul.

Secretary's note: The letter sent to the Treasury in accordance with this action read as follows:

"At today's meeting, the Executive Committee of the Federal Open Market Committee considered the money and security market outlook and the prospective developments of Treasury finance during the current quarter. The Committee concluded that it would be desirable to utilize funds accumulated in Treasury balances with commercial banks for the purpose of redeeming maturing bill issues during this period, in order to counteract excessive ease in the money market.

"The Committee recommends the retirement of 200 million dollars of maturing Treasury bill issues weekly for the next four weeks. It is also suggested that, if prospects for Treasury expenditures and receipts justify, 100 million of maturing bills be paid off weekly during the subsequent weeks of May and June, in addition to a substantial cash payment on the June 1 certificate issue. In order to make this program effective as a means of absorbing reserves, funds needed to retire bills should be obtained through calls on war loan deposits.

"If this recommendation is accepted, it is further suggested that the Treasury announce to the public that 200 "million of the following weeks' Treasury bill issue is to be redeemed as part of its program of debt reduction, without announcing in advance a detailed program of amounts and duration of bill retirements. In view of the condition of the market, we believe it wise to create this element of uncertainty.

"Current estimates indicate that a program of this kind would leave the Treasury with an adequate balance at the end of the fiscal year. Assuming retirement of 1.6 billion dollars of bills in the next three months and of 1 billion of certificates in June, it appears that the Treasury balance at the end of the period will still be well above 2 billion, with war loan deposits of about 1 billion."

Chairman Eccles stated that he had come to the conclusion that, if any progress was to be made with the Treasury in getting an agreement to discontinue the posted rate on Treasury bills and to permit the bill rate to rise to a level which would be determined by the market in line with the 7/8 per cent rate on certificates, it would be necessary to present to the Treasury a program pursuant to which the increased cost of Treasury financing that might result from the changed bill program would be offset by paying into the Treasury a substantial portion of the net earnings of the Reserve Banks. He thought that the Treasury would not be willing to agree now to eliminate the posted rate on the basis of the introduction and passage of legislation to restore the franchise tax which probably would require a number of months, and that therefore the Board of Governors should immediately prescribe an interest rate on Federal Reserve notes under the provisions of the fourth paragraph of Section 16 of the Federal Reserve Act, the first payment to be made to the Treasury in April on Federal Reserve notes outstanding during the first quarter of the year. If this were done, he said, then the Treasury could agree to a higher rate on Treasury bills with the assurance that the increased interest cost would be returned to the Treasury in the form of interest payments on Federal Reserve notes. He added that, with such a procedure in mind, the Board and its staff had been studying the matter and that Mr. Smead had prepared a memorandum under date of March 28, 1947, in which he discussed the alternative methods that might be used to impose an interest charge on Federal Reserve notes for the purpose of paying to the Treasury approximately 90 per cent of the annual net earnings of the Federal Reserve Banks. The most important question presented by the memorandum was whether the rate fixed by the Board of Governors should be a single uniform rate for all Federal Reserve Banks or a separate rate for each Bank.

The memorandum was read, together with excerpts from a letter written on April 22, 1920, by Governor Harding of the Federal Reserve Board to the Chairman of a Federal Reserve Bank in response to suggestions that member banks should receive a greater portion of the earnings of the Federal Reserve Banks. The letter concluded with the statement that if serious attempts were to be made to change the method of distribution of the earnings of Federal Reserve Banks by diverting a larger portion of the earnings from the Treasury to the coffers of member banks, the Board would feel obliged to protect the interests of the Treasury by assuring to it in advance of any general distribution of earnings the revenue which would accrue from the imposition of a tax on Federal Reserve notes.

Chairman Eccles stated that the question whether an interest charge on Federal Reserve notes should be imposed was a matter for determination by the Board of Governors, that the Board had not yet taken any action with respect to it, and that he was presenting it for discussion by the executive committee because of its close relationship to the decisions to be made with respect to the posted rate on Treasury bills and other questions of open market and Treasury financing policy. He felt that when the matter was considered by the Board it would be helpful to have the benefit of the views and, if thought desirable, the recommendation of the executive committee. He made the further statement that he had discussed the matter in the hearings before the House Banking and Currency Committee on the extension of the authority to make direct purchases, and that no objection was raised by the Committee to the application of an interest charge on Federal Reserve notes. He also said that he proposed to meet informally with the subcommittee of the Senate Banking and Currency Committee which had been assigned the responsibility of considering matters relating to the Federal Reserve

System and that, if no objection were offered, the Board should feel free to take action. He went on to say that a question had been raised whether it was ever intended that the authority to prescribe an interest charge on Federal Reserve notes would be used to channel Federal Reserve Bank earnings into the Treasury, that the question was a debatable one, but that the Board's counsel had taken the position that the terms of the law were clear, that the legislative history indicated that it might be used for that purpose, that certainly Governor Harding in 1920 felt satisfied that the authority could be used in that way, and that if no objection were raised by the Chairmen of the Banking and Currency Committees there would be no point in withholding action in favor of steps to restore the franchise tax. He again expressed the opinion that the establishment of an interest charge would have all of the advantages of a franchise tax without raising the question that might be presented by a proposal to restore the franchise tax.

Chairman Eccles then discussed briefly the difficulties that would be presented by an attempt to fix an interest charge which would be uniform for all Federal Reserve Banks. Such a rate undoubtedly would require substantial and frequent reallocations of securities in the System account, complete revision of the formula now in effect for the allocation of securities, and a reconsideration by the Federal Open Market Committee and the 12 Federal Reserve Banks of the whole question of allocation procedure. If that were done, it was Chairman Eccles' view that action should be delayed until the matter could be discussed at the meeting with the Presidents of the Federal Reserve Banks in June which would delay until that time any action with respect to the posted rate on Treasury bills. He saw no adequate reason, however, for a uniform rate and it was his thought that, for the purpose of channeling approximately 90 per cent of the earnings of the Federal Reserve Banks into the Treasury, an individual rate for each Federal Reserve Bank would be more logical and a more satisfactory means of accomplishing that objective.

Mr. Smead stated that at first he favored the uniform rate, but that after considering the difficulties involved in a single rate he had come to the conclusion that a separate rate for each Federal Reserve Bank would be not only more practicable but more satisfactory, on the assumption that a statement would be issued to the press which would make it entirely clear that the interest charge was imposed for the sole purpose of effecting the payment of 90 per cent of the net earnings of each Federal Reserve Bank to the Treasury.

Mr. Vest stated that the authority of the Board to impose the interest charge was clear, that the language of the Act was unconditional, that while it had been indicated that the authority was given as a means of restricting the expansion of Federal Reserve notes in circulation it did not appear that that was the only purpose, and that the legislative history indicated that there was at least some consideration given to using the authority to transfer some of the earnings of the Federal Reserve Banks to the Treasury.

Mr. Sproul stated that he had favored the restoration of the franchise tax as the most satisfactory way to solve the problem of excess earnings of the Federal Reserve Banks, and that he still felt that would be the best solution for the reasons (1) that in his opinion the primary purpose of the authority to impose an interest charge on Federal Reserve notes uncovered by gold was the belief that this authority could be used to restrict the circulation of such notes and thus to restrain inflationary tendencies and there was a real question as to whether Congress intended the authority to be used in the manner proposed, and more important (2) that the System should avoid raising any question or creating concern as to the soundness of the currency and should avoid distinctions between notes covered by gold and those not so covered. If the interest charge on uncovered Federal Reserve notes is to be established by the Board of Governors, he said discussions with the Banking and Currency Committees of both Houses of Congress and a clear and frank press statement as to why the authority was being used for the purpose of effecting payment of excess earnings to the Treasury, were both necessary and desirable. He added that, if these things were to be done, and if the alternative of a restoration of the franchise tax would mean extended delay and prevent effective negotiation with the Treasury with respect to the elimination of the posted rate on Treasury bills and eventually some change in short-term interest rates, he would have to go along with the proposal for the establishment of the interest charge. He felt that action with respect to the restoration of some measure of control over bank credit at this time was more important than the means to be used in siphoning some of the earnings of the Federal Reserve Banks into the Treasury, and that the discussions of the matter with the Banking and Currency Committees and the issuance of a satisfactory press statement should dispel at least to some extent the dangers which might otherwise exist.

With respect to a uniform interest rate for all Federal Reserve Banks, Mr. Sproul said he had thought that it would be desirable to have such a rate as it would clearly emphasize that it was a means of bringing some of the earnings of the Federal Reserve Banks into the Treasury and was not related in any way to excessive currency circulation. He was of the opinion, however, that the difficulties which would attend a uniform rate were very persuasive and if they were so great as to force substantial and frequent allocations of securities in the System account he would not regard the single rate as essential. He added that he would concur in the establishment of the interest charge on the basis of obtaining a satisfactory agreement with the Treasury with respect to the posted rates and some possible further freedom of action with respect to other short-term rates.

Mr. Davis stated that he would dislike to see the Board take a position in opposition to the franchise tax, that if the question of an interest charge on Federal Reserve notes were presented to the Congress on the basis of a franchise tax being the direct way but also being subject to the delays that would attend the enactment of legislation, there was reason for establishing the interest charge on a current basis rather than waiting until the end of the year. He had no opinion on the question whether there should be a uniform interest charge or a separate charge for each Federal Reserve Bank. He felt that if accompanied by a well prepared statement there would not be much difference from a public standpoint between a uniform and individual rate.

Following discussion of the questions that might be raised by the suggestion that the franchise tax be restored, Chairman Eccles stated that it was expected that the Board of Governors would consider shortly the question of establishing the interest charge on

Federal Reserve notes and that it would be helpful if the executive committee could make a recommendation with respect to the matter.

> Mr. Vardaman moved that it be the consensus of the executive committee that the Board give favorable consideration to the establishment of an interest charge on Federal Reserve notes pursuant to the provisions of section 16 of the Federal Reserve Act, it being understood that there would be an appropriate clearance of the action through the Chairman of the Senate Banking and Currency Committee and that an adequate press statement of the Board's action would be issued.

In a further discussion, Mr. Rouse suggested that consideration might be given to applying the interest charge in such a manner as to effect some equalization of the surplus accounts of the respective Federal Reserve Banks in relation to their capital and it was the consensus that this question might well be studied. In this connection, Chairman Eccles stated that, if Congress should adopt the legislation now before it which would authorize the Federal Reserve Banks to guarantee loans to industry and the time came when the Federal Reserve Banks had a substantial contingent liability on such loans, he would want to consider the advisability of reducing the interest charge on Federal Reserve notes in order to enable the Federal Reserve Banks to build up the necessary reserves against possible losses on such loans.

At the conclusion of the discussion, Mr. Vardaman's motion, having been duly seconded, was put by the chair and carried unanimously, Mr. Sproul's vote being cast in the light of the statement which he had made earlier in the meeting of his views regarding the establishment of an interest rate on Federal Reserve notes.

All of the members of the committee present were agreeable to giving to the Federal Reserve Bank of New York all of the remaining authority granted to the executive committee by the Federal Open Market Committee to execute transactions in the System account, and, upon motion duly made and seconded and by unanimous vote, the executive committee directed the Federal Reserve Bank of New York until otherwise directed by the executive committee,

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account, either in the open market or directly from, to, or with the Treasury, as may be necessary in the practical administration of the account or for the purpose of maintaining an orderly market in Treasury securities and a general level of prices and yields of Government securities which will support the Treasury issuing rates of 7/8 per cent for one-year certificates and 2-1/2 per cent for 27-year bonds restricted as to ownership; provided (a) that the total amount of securities in the account at the close of March 1, 1947, shall not be increased or decreased by more than $1,500,000,000 [exclusive of bills purchased outright in the market on a discount basis at the rate of 3/8 per cent per annum and bills redeemed at maturity, and special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction] and (b) that this paragraph shall not limit the amount of Treasury bills purchased pursuant to the direction of the Federal Open Market

Committee issued under date of March 1, 1945, or the redemption of such bills;

(2) To purchase direct from the Treasury for the System open market account such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held in the account at any one time shall not exceed $750,000,000; and

(3) Upon approval by a majority of the members of the executive committee, which may be obtained by telephone, telegraph, or mail, to make such other purchases, sales, or exchanges for the account as may be found to be desirable within the limits of the authority granted to the executive committee by the Federal Open Market Committee.

In taking this action, it was understood (a) that the limitations contained in the direction included commitments for purchases or sales of securities for the System account, and (b) that the authority referred to in paragraph (2) of the direction would not be exercised until after approval of pending legislation extending the authority of the Federal Reserve Banks to purchase Government securities directly from the Treasury.

There was a discussion of the likelihood of a need for sales and redemptions of securities in the System account in excess of the authority granted to the executive committee by the Federal Open Market Committee and it was agreed that, since it appeared that further contemplated retirement of Government debt before another meeting of the full Committee might make it necessary for the executive committee to have further authority to reduce the amount of securities in the System account, the executive committee should request the full Committee to increase the limitation contained in the first paragraph of the direction issued to the executive committee on March 1, 1947, from $1,500 million to $2 billion.

> Upon motion duly made and seconded, and by unanimous vote, the members of the executive committee agreed that such increased authority should be given by the full Committee to the executive committee and that a request for such authority should be made of the other members of the full Committee.

In connection with a discussion of the date for the next meeting of the executive committee, Chairman Eccles stated that he would be leaving to be in California on April 21, 1947, and might not be back in Washington until May 12, but that Mr. Szymczak would be back toward the end of this month and could serve as an alternate member of the executive committee.

> It was agreed unanimously to fix May 2 as a tentative date for the next meeting of the committee.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.