

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 Wednesday, February 14, 1951, at 2:45 p.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Evans
Mr. C. S. Young

Mr. Szymczak, Member, Federal Open Market Committee

Mr. Carpenter, Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Leach, Economist, Division of Research and Statistics, Board of Governors

For the purpose of bringing the members of the committee up to date on developments since the meetings last week, particularly developments on Saturday, February 10, Chairman McCabe read a memorandum which he had prepared as follows:

"This morning, after reading in the newspaper that John Snyder expected to go to the hospital tomorrow, February 11, I telephoned to Allan Sproul and talked to him about the desirability of calling Snyder to ask him who would be authorized to discuss open market operations and if anyone were authorized to give us an answer to the memorandum we had presented to him a few days ago. Sproul agreed with me that I should telephone Snyder, which I did in mid-morning.

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"I told Snyder that I was very sorry to hear that he had to go to the hospital, and he told me that the doctor thought he should go now. He asked me if I had received a letter from him as he had written me on yesterday (Friday) saying that he would have to have the operation, that he expected to be back in about two weeks. I told him that I had not received the letter, which he thought would be in my hands late Friday afternoon. He said that we could take up our questions with Bill Martin during his absence but he hoped that the major question, as outlined in our last letter to him, would be postponed until his return. I told him that I would have to take up the question of postponement with the Open Market Committee as I could not answer for them. He laughed and said he understood that.

"Within an hour after talking with Snyder, I received a telephone call from Senator Maybank, who told me that he was in Senator Robertson's office with Senator O'Mahoney and Senator Robertson. Senator Maybank said that Snyder had been in touch with him and told him generally what he had told me over the telephone. Senator Maybank made a strong plea with me to grant Snyder's request and postpone any major change in our bond support program until Snyder had returned as he thought Snyder's request was a fair one, and he thought Snyder might hesitate about going to the hospital if he thought it might be construed that he was getting away for the purpose of postponing a decision. Senators Robertson and O'Mahoney got on the phone and made essentially the same plea as Senator Maybank.

"Senator O'Mahoney told me that Congressman Fatman was anxious to conduct public hearings on the controversy with the Treasury, that he was very critical of the Federal Reserve. Senator Robertson told me that Senator Capehart had pressed him hard for a public hearing.

"I told these gentlemen that I could not assume the responsibility of speaking for the Open Market Committee, but that I would try to reach the members of the Executive Committee of the Open Market Committee and ascertain their views. Senator O'Mahoney asked me to telephone him at his office in the afternoon and let him know what to expect. All three of these Senators brought up during the telephone conversation with me our letter to the President and strongly urged that I have the letter withdrawn as they thought it would be a mistake to have it publicized at this time. Snyder made a similar request when he talked with me.

"I telephoned to Allan Sproul and it was his opinion that we should not withdraw the letter to the President, but that we should indicate that we would not publicize the letter and that the

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"White House could use its own discretion about making it public. He thought the letter should stand as the view of the Open Market Committee. He said further that he did not think we should commit the Open Market Committee in advance of the meeting of its Executive Committee next Wednesday.

"I then phoned Governor Evans, who seemed to think we should not oppose the request of the Senators to defer action for two more weeks and that we should tell them that the matter would be taken up and passed upon at the meeting of the Executive Committee of the Open Market Committee next Wednesday. He was not in favor of withdrawing the letter.

"I telephoned then to President Young in Chicago and he took very much the same view as Governor Evans.

"I saw Governor Eccles at the Shoreham and invited him to my apartment. His opinion was very much the same as Allan Sproul's. I asked Governor Eccles to stand by until I had telephoned to Senator Robertson and Senator O'Mahoney.

"In my conversation with Senator Robertson, I told him that my informal contacts with the members of the Open Market Executive Committee indicated that they were disappointed that Mr. Snyder had not reached a decision before he went to the hospital and that they would agree to a postponement with reluctance. I said that we felt we had a very grave responsibility in checking inflation and we were disturbed by the substantial amount of Government bonds that we were purchasing, and that these purchases were furnishing reserves to the banking system and thus were the basis of multiple credit expansion. I told him that I doubted Mr. Snyder would be out of the hospital within the two weeks' period, and that it must be understood that even though the Open Market Committee might agree to a two weeks' postponement, it must be understood it could not be for more than two weeks. He said we might consider asking Snyder to postpone the time for entering the hospital in order to settle the question. I replied that I did not feel like taking the responsibility of asking him to postpone an operation which seemed so vital to him.

"I then called Senator O'Mahoney and told him substantially what I had told Senator Robertson. Senator O'Mahoney reiterated a strong plea to have us take back the letter to the President, but I told him there was reluctance on the part of the Executive Committee to ask for its return as it was a reply to the President's letter. I told him we would not press for the public release of our letter to the President and that it would be optional with him as to giving it to the press. This did not seem to satisfy Senator O'Mahoney. He said that Congressman Patman was pressing for a public hearing and wanted to be appointed chairman of the subcommittee to conduct the

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"hearings. He said he had asked Patman not to press the matter during the two weeks' period.

"It was evident from my conversations with the Senators that they were fearful of publicity of our letter to the President and of public hearings.

"I spent the rest of the afternoon discussing various Federal Reserve problems with Marriner Eccles."

In response to a question from Chairman McCabe as to whether the memorandum covered the principal points with which Mr. Eccles was familiar, Mr. Eccles stated that in the telephone conversation with Senator O'Mahoney, referred to in the memorandum, Chairman McCabe placed great emphasis on the fact that the System was buying long-term Treasury bonds at a premium, that he had reiterated this fact several times and had said that by paying a premium on the bonds the System was inviting their sale by others, and that he felt the System should not be required to pay this premium even if it seemed necessary to maintain par on the outstanding issues at the present time. Mr. Eccles also stated that the Chairman had pointed out to the Senator when he was discussing the suggestion that the letter sent to the President on February 7 be withdrawn, that the letter was one which had been agreed upon by the entire Federal Open Market Committee except for one member, that it was impossible to withdraw a letter that was sent with the approval of eleven members of the Committee without getting their consent to its withdrawal, and that the executive committee could not take such action. Another point which Mr. Eccles recalled the Chairman had mentioned was the remark that if Secretary of the Treasury Snyder could not return from the hospital within two weeks there should

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by all means be some arrangement whereby somebody else in the Treasury would have authority to make policy decisions in an emergency situation.

Chairman McCabe added that Senator O'Mahoney stated that he understood there had been additional legal authority given to the Treasury since the Banking Act of 1935 with respect to the management of the public debt and the terms on which Treasury offerings might be made, but that after looking into this matter, Mr. Vest had informed him that he had not been able to find anything that met the description given by Senator O'Mahoney of such authority. Chairman McCabe also said that he commented to Senator O'Mahoney that, although Secretary Snyder had stated he would be out of the hospital within about two weeks, it appeared from the experience of one of the members of the Board's staff (Mr. Leonard) that an operation of the type the Secretary was undergoing might delay his return to the office for as much as a couple of months, to which Senator O'Mahoney responded that if the Secretary was not back within two weeks he would not ask for a further delay, that he thought the matter ought to be completely reviewed, and that no one could ask the committee to go beyond the two-week period in delaying action.

The Chairman then referred to a letter from the Secretary of the Treasury dated February 9, bearing a post-office cancellation of 11:30 a.m. February 10, and received in his office on February 12, as follows:

"I have your letter dated February 7, to which we are giving careful study.

"I am planning to go to the hospital Sunday to have the eye operation which you know I have been postponing for some

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"time. This is about the only time I can get away in view of the fact that within a few weeks, I will have to be on the Hill again in connection with the tax program. I have been advised that the Committee has scheduled a number of public witnesses and that my personal appearance will not be necessary for awhile.

"Upon my return, we can arrange to have conferences on the Debt Management Program."

The Chairman then stated that on Tuesday, February 13, there was delivered to his office a letter from Senator O'Mahoney dated February 10, as follows:

"May I not send this brief note to summarize the opinions which I expressed to you and to Mr. Allan Sproul at our conference in your office on the morning of Thursday, February 8, with respect to the conflict over federal debt management.

"1. The soviet dictators are convinced that the capitalistic world will wreck itself by economic collapse arising from the inability or unwillingness of different segments of the population to unite upon economic policy.

"2. Inflation in the United States is the result of no single cause and therefore cannot be remedied by a single cure, but only by a variety of policies of which taxation to establish a 'pay-as-you-go' policy and economy in government expenditures will be the most effective.

"3. High interest rates on commercial paper are of themselves no obstacle to inflation. Witness the fact that call money in New York before the crash in 1929 on the average was higher than 10% while the yield on short-term governments was at times higher than 5%. In a run-a-way inflation the cost of bank credit is no deterrent to borrowers who think they know how to take advantage of rising prices.

"4. Rising prices after Korea resulted largely from scare buying, hoarding and profiteering by those who sought to gain favorable positions for themselves by hedging against inflationary controls which were widely believed to be inevitable because of the beginning of the war and the military preparedness program.

"5. With a national debt of 257 billion dollars of which 155 billions are in marketable securities of the government and 58 billions are in savings bonds which are actually demand notes, a policy intended to drive down the market value of the marketable securities would, if successful, undermine the confidence of the holders of the savings bonds and might precipitate a rush to redeem.

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"6. If the price of outstanding bonds is driven to par because the Federal Reserve Board desires to save the premium of 22/32 which has been currently paid, no one can predict what other sales at lower prices may result and how much the Treasury will be forced to increase interest rates on new issues, if needed.

"7. We can determine exactly how much an increase of interest rates on new issues will cost the government, and, with the annual service charge now running at a total of 5.8 billion dollars, the rising cost to the government of carrying the debt by reason of increased interest is perfectly obvious.

"8. While it is possible to compute exactly the cost of increased rates on governments, we can only guess what effect higher interest rates on bank borrowings will have on bank credit expansion.

"9. It is imperative in this crisis that there should be no conflict between the Federal Reserve Board and the Treasury the two most important fiscal agencies in the world upon the intelligence and patriotic cooperation of which may depend the success of this nation in the ideological conflict with Russia.

"I appreciate very much the opportunity of discussing this and other problems with you and your associates. These conferences are always helpful."

Chairman McCabe went on to say that this morning he telephoned Assistant Secretary of the Treasury Martin and told him that Secretary Snyder had given him to understand that during the latter's absence Mr. Martin was the person with whom he should communicate at the Treasury on any questions concerning Treasury financing. The Chairman said he told Mr. Martin that the executive committee of the Federal Open Market Committee was meeting in Washington today and that he and Mr. Sproul would be glad to talk with him at some convenient time during the day. Chairman McCabe went on to say that Mr. Martin came over and the problem before the Treasury and the Federal Open Market Committee was extensively reviewed.

Mr. R. A. Young, Director of the Division of Research and Statistics, Board of Governors, joined the meeting at this point.

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Mr. Sproul expressed the opinion that there were two matters before the executive committee, (1) whether the letter to the President should be withdrawn, and (2) whether assurance would be given to anyone that no change in the existing basis for open market operations would be made for a period of two weeks. It was strongly his view that the letter should not be withdrawn and that assurances of the kind referred to should not be given at a time when conditions were changing so rapidly and the responsibilities of the Federal Open Market Committee might require that some action be taken.

Other members of the executive committee expressed concurrence with Mr. Sproul's views and it was agreed unanimously that the letter to the President would not be withdrawn.

There was a discussion of the whole problem of System credit policy and its relationship to Treasury debt management in the light of the developments that had taken place, the effectiveness of a more restrictive credit policy in retarding the growth of bank credit, the basis upon which further discussions with the Treasury should be conducted, and what other conclusions were called for by the executive committee at this time.

In a discussion of the additional authority that should be requested from the Congress by the Board of Governors with respect to bank reserve requirements, it was the consensus that an increase in the present maximum legal requirements should be requested, and that the increased authority should be made applicable to nonmember as well as member banks with the understanding that nonmember banks should be permitted to carry

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their reserve requirements with their correspondents or with the Federal Reserve Bank and supervision of the requirements so far as nonmember banks was concerned should be placed in the hands of the State bank supervisors. There was agreement with the suggestion by Mr. Sproul that any request for additional authority over reserve requirements should not be advanced as a reason for delaying the use of the existing powers of the System should conditions call for their use.

Chairman McCabe stated that the remaining immediate question before the executive committee was the response to be made to the request of the Secretary of the Treasury for a two-week delay in any change in the present basis of open market operations of the System.

During the discussion of this and other points, Chairman McCabe stated that Assistant Secretary of the Treasury Martin was anxious to have staff-level discussions of the whole problem presented by the letter to the Secretary of the Treasury dated February 7, 1951, and that it was his (Chairman McCabe's) assumption that such discussions would be carried on on the basis of that letter. This understanding was unanimously agreed to.

There was also a discussion of the nature of the reply to be made to the letter from Senator O'Mahoney and it was understood that a reply would be drafted and sent upon the approval of Chairman McCabe.

Secretary's note: The reply sent to Senator O'Mahoney on February 23, 1951, in accordance with this understanding was as follows:

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"Thank you very much for your letter of February 10, summarizing your views on monetary and debt management policy. I intended to respond more promptly but the pressures here have been exceptionally heavy. I should like to set down my views in order that we may be able in a very friendly way to see where our opinions coincide, as I think they do at most points, and where we may perhaps differ.

"(1) I agree with you entirely that the Soviet dictators would like to bring about our economic collapse and, as you know, inflation is perhaps the greatest force for arraying the various sectors of a capitalistic economy against each other. John Maynard Keynes stated in his 'Economic Consequences of the Peace' (1919): 'Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency...Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of Society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.'

"(2) We are in agreement that inflation in the United States is the result of no single cause and can be remedied by no single cure. A major cause of the inflation since Korea, however, has been abnormal spending by individuals and businesses financed by the liquidation of Government security holdings and by an unprecedented volume of borrowing, particularly from banks. Inflation occurred despite a balanced Federal budget, and a prompt increase in taxes. Under the conditions in prospect, even if the essential pay-as-you-go taxes are adopted, further inflation cannot be prevented without effective restraints on business and other private borrowing combined with appropriate debt management policies.

"(3) I would like to make clear my view that anti-inflation restraint through monetary and credit action is not effected through interest rates alone. It is augmented through measures and actions designed to limit the availability of bank reserves, the effect of which is to reduce the willingness of bankers to lend. When credit demand is active, all such limitations on the supply of credit necessarily affect interest levels. In 1919-20, restraining action by the Federal Reserve was too long delayed but, once taken, was too drastic and was too long continued. The action was followed by termination of the boom. Certainly it cannot be said that monetary action was ineffective in curbing inflationary pressures at that time.

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"Restraint on the availability of bank reserves in the late 1920's, (reflected in part in the interest levels of the period), effectively prevented an expansion by banks of the money supply. Prices of commodities and services remained relatively stable during this period. The great inflation was in stock prices with stock purchases heavily financed through stock market loans by others than banks. Despite a potential return on their money as high as 8 to 10 per cent on the average in the call market for loans on stock exchange collateral, member banks did not expand these loans. Yields on short-term Government securities averaged about 4-1/2 per cent in late 1928 and early 1929, compared with about 3 per cent previously, while yields on long-term Government bonds rose only from 3-1/4 per cent to about 3-5/8 per cent. The mistake of the Federal Reserve authorities in this period was that restraining action was too long delayed and was inadequate.

"(4) I agree with you that rising prices after Korea resulted largely from scare buying, hoarding, and profiteering. This was financed with a steady rise in national income as well as with cash obtained from liquidating Government securities in a supported market, and on the basis of unprecedented resort to credit which was all too freely available. If liquidation of Government securities had not been so free and if credit had not been so readily available, prices could not have been bid up as much as they were. Excessive buying still continues without sign of let-up, if not in fact at an accelerated pace. It is still being made possible to an important degree by a shockingly large growth in bank loans and by liquidation of Government securities at prices that do not retard such liquidation.

"(5) and (6) Confidence of the public in Government securities as well as in other forms of liquid savings is inextricably bound up with public confidence in the value of the dollar. With the large overhand of such liquid savings, and considering among other things the heavy maturities of savings bonds coming up next year, it is extremely important that confidence in the dollar be firmly established by Government policies that destroy the inflation threat at its roots. Continuation of too easy money policies will make it next to impossible to engender confidence in the sustained real value of Government securities.

"(7) and (8) The interest cost on the public debt should be as low as is consistent with economic stability. Interest rates should be high enough, however, so that the debt will be bought and firmly held by the investing public and will not need the support of an undue amount of money creation. Figures on additional interest cost that have been widely quoted are many times larger than any increase that is likely to occur in the

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"next several years. We should also keep in mind that interest rates on short-term Government securities also decline in periods of recession as they did in the 30's and more recently in 1949. I am old fashioned enough to believe that history will repeat itself and that over a period of years interest rates will fluctuate with changing economic conditions.

"(9) The Federal Reserve has always tried to avoid conflict with the Treasury. The record over the years shows patience, compromise and much sacrifice of basic convictions to this end. I am still hopeful that a basis of mutual understanding and agreement can be reached. If not, we will have no defensible alternative save but to do what, in our considered judgment, is for the best interests of the country, in accordance with our statutory responsibilities. We can, of course, always go to the Congress that created us and to whom we report and appeal for a redefinition of our responsibilities.

"It is gratifying to have had this opportunity for frank interchange of views with you. I hope we will continue to confer whenever it may be helpful to either of us to do so."

At the conclusion of the discussion, it was agreed that the position of the executive committee with respect to the request of the Secretary of the Treasury for a two-week delay, should be that if the market offerings of long-term restricted bonds continued and the System was called upon to purchase these issues in the volume purchased during the last few days, it would be necessary for the executive committee to take action to permit the System's support price to decline, and that in that event Messrs. McCabe and Sproul would endeavor to confer with the representative of the Treasury who would have authority to discuss the matter and to advise him of the action which it was felt should be taken.

Chairman McCabe then called upon Mr. Rouse for a report of open market operations since the meeting of the executive committee on January 31. Mr. Rouse presented reports prepared at the Federal Reserve Bank of

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New York covering commitments executed from January 31 to February 5, inclusive, and from February 6 to February 13, 1951, inclusive. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account, as reported to the members of the executive committee for the period January 31, 1951 to February 13, 1951, inclusive, were approved, ratified, and confirmed.

It was agreed that no action need be taken at this meeting with respect to the direction issued by the executive committee to the Federal Reserve Bank of New York on February 8, 1951.

Mr. Carpenter stated that a wire had been received from the Secretary of the Federal Reserve Bank of Dallas dated February 8, 1951, advising that the directors of that Bank had elected President Gilbert a member of the Federal Open Market Committee for a one-year term beginning March 1, 1951, and W. S. McLarin, Jr., President of the Federal Reserve Bank of Atlanta, as Mr. Gilbert's alternate. Mr. Carpenter suggested that, inasmuch as Mr. McLarin had requested retirement effective February 28, 1951, the following wire to the Dallas bank be approved:

"Your wire February 8 relating to election of Messrs. Gilbert and McLarin as member and alternate member respectively of Federal Open Market Committee for year beginning March 1. Inasmuch as Mr. McLarin has requested retirement effective February 28, assume that at next meeting of your board of directors you will elect another alternate member in Mr. McLarin's stead."

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Upon motion duly made and seconded,
the wire was approved unanimously.

It was agreed that the date for the next meeting of the executive
committee should be subject to call.

Thereupon the meeting adjourned.


Secretary.