

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 on Monday, February 26, 1951, at 9:15 a.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. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. R. A. Young, Director, Division of Research and Statistics, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Chairman McCabe stated that he received a telephone call yesterday from Mr. Murphy, Special Counsel to the President, asking that he attend a meeting to be held at the White House at eleven o'clock this morning at which, in addition to himself, there would also be present Mr. C. E. Wilson, Director of the Office of Defense Mobilization, the members of the Council of Economic Advisers, Under Secretary of the Treasury Foley in the absence because of illness of Secretary Snyder, and Mr. McDonald, Chairman of the Securities and Exchange Commission. Chairman McCabe stated that he

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called Mr. Murphy on the telephone this morning to tell him that the executive committee of the Federal Open Market Committee was meeting today, that Mr. Sproul would be in Washington, and that he felt it would be desirable if Mr. Sproul also could attend the meeting since it involved a discussion of matters before the Federal Open Market Committee, and that Mr. Murphy responded that he would let him hear from him later.

Chairman McCabe then said that, as stated at the meeting of the executive committee on February 14, Assistant Secretary of the Treasury Martin had suggested that members of the staff of the Treasury Department and the Federal Reserve meet to consider matters of mutual interest to the Federal Open Market Committee and the Treasury, that Under Secretary of the Treasury Foley subsequently called him on the telephone and made the same suggestion, and that pursuant to this suggestion a luncheon meeting was arranged in his (Chairman McCabe's) office on Tuesday, February 20, 1951, at which Mr. Martin, Mr. Haas, Director of the Technical Staff of the Treasury, and Mr. Bartelt, Fiscal Assistant Secretary of the Treasury, and Messrs. Riefner and Thomas were present, and that meetings at which Mr. Rouse was present were continued that evening and on subsequent days through Friday morning, February 23, 1951. Chairman McCabe stated that before the meetings started he requested that Mr. Martin be included as one of the Treasury representatives and that the letter sent to Secretary of the Treasury Snyder by the Federal Open Market Committee under date of February 7 be the agenda for the discussions, and that his request was agreed to

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with the understanding that some other matters might also be taken up.

The Chairman then referred to a memorandum covering the foregoing discussions which had been prepared by Mr. Martin of the Treasury and contained revisions made by Mr. Riefler and agreed to by Mr. Martin. At Chairman McCabe's request the Secretary read the memorandum which concluded with the statement that at the end of the meetings it was made clear again that the conversations were only exploratory talks at the technical level and that it was suggested that the matter be referred to a higher level where negotiations or counter-proposals might take place.

Chairman McCabe then made a statement substantially as follows:

Last night Under Secretary of the Treasury Foley called me on the telephone about nine o'clock and said that Secretary Snyder was still in the hospital and that he thought it might be a matter of two more weeks before he was fully recovered. He made a very strong plea that these staff discussions be continued and that they be resumed this morning. He felt that substantial progress was being made, that they had devoted most of the time to discussing the February 7 letter from the Federal Open Market Committee to the Secretary of the Treasury, and that now other ideas should be discussed. I said I was sure that the Committee would be reluctant to consider a further delay, that 18 days had elapsed since we talked with the Secretary of the Treasury and presented our letter, and that it seemed that ample time had been given for discussion of various views.

I told Mr. Foley that there was to be ^a meeting of the executive committee this morning at nine o'clock and that I would present his views to the committee, but that I felt that the committee would be very much concerned about the fact that it was still buying very substantial amounts of Government bonds and creating reserves which was highly inflationary. Mr. Foley said that he had not been able to present the question to Secretary Snyder in the way in which he would like because of his condition, but that they were going to see him again today, and I suggested that there should be someone in the Treasury authorized to act in the absence of the Secretary.

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With reference to the meeting at the White House at eleven o'clock this morning, I think it likely that the position will be taken that the memorandum which I sent to Mr. Wilson on financial mobilization on January 16 has been studied and that there is about to be launched a complete study of financial mobilization. There will be a plea for everybody to cooperate in the study until it is completed. My guess is that the time limit on that will be about the same as the two-week period that Mr. Foley indicated would elapse before Secretary Snyder got back. It appears that the question of the financial mobilization program has gone beyond Mr. Wilson and that they have brought in the Council of Economic Advisers and the Treasury so that the studies suggested will be along a somewhat different line than was contemplated in my memorandum.

I would suggest that we discuss the matter generally at the meeting this morning and that the committee not take definite action as to what our response would be, but that we report back after we have met with the President and others at the White House.

Mr. Sproul stated that he had summarized his views in the form of questions and answers concerning the program the Federal Open Market Committee was attempting to follow, and he then read the questions and answers as follows:

1. What are we trying to do?

Quit providing easy reserves to the banking system to feed an inflationary expansion of credit. Quit monetizing the Federal debt.

2. How do we propose to do it?

(a) By cutting down our ready buying of short securities so that the discount rate becomes effective and the strong tradition of the banks against borrowing heavily and continuously comes to our aid.

(b) By relieving ourselves of rigid support of the long-term market, either by allowing the price of

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outstanding issues to decline to a point where rigid support will not be necessary, or by getting rid of weakly held outstanding bonds with an exchange offering.

3. Why is this the time to do it?

Because expansion of credit is still a strong inflationary factor, because further tax increases seem to be some months off, because direct controls are in a preliminary and ineffective state, and because the Treasury has no need to come to the market for refunding or new money.

4. Is this a new policy on our part?

Quite the reverse. This is the policy and program we forecast in June 1949 with Treasury blessing, which we reiterated in August 1950 over Treasury opposition, and which we have made the basis of our subsequent struggle against pressure and intimidation. It is the only policy consistent with the present economic situation and our responsibilities to the Congress and to the nation.

5. Does such a policy usurp the debt management functions of the Treasury?

Certainly not. The essence of debt management is to tailor your offerings to the market in terms of the existing economic situation, not to have the market tailored to your offerings by the central bank. When the Treasury has to come to the market later in the year we hope it will tailor its offerings to the market. If it doesn't, however, we shall have to see that they go over.

6. What harm can come from such a policy?

The steps we have already taken to implement such a policy in the short area have been beneficial not harmful. In nearly every other country with an economic organization similar to ours, adjustments upward in long rates and downward in prices, in response to market forces, have taken place without disaster--in fact quite the reverse. We have created our own par bogey, but we ought to quit being frightened into an inexcusable credit policy by it.

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7. What benefits would come from such a policy?

It would not stop inflation, but it would restrain the expansion of bank credit and it would make inflation less easy and less certain, while we are passing tax legislation to make "pay-as-we-go" a reality, while price and wage controls are being perfected for whatever they are worth as a temporary obstacle to inflation, and while production is being increased. It might also encourage the Treasury to adopt a debt management program which will concentrate on mopping up savings--individual and institutional--and minimize the use of bank credit. (The cost to the Treasury would be many times less than the costs of further inflation.) It would give the country a welcome injection of courage in fighting inflation. There isn't much faith in us or anyone else on this score now.

8. What is there to hold us back?

Nothing but our own inhibitions. If what we do is not what Congress and the country wants we shall soon find out. Meanwhile the rearmament program will go on, production and employment will continue to bump the ceiling, and when the Treasury has to come to the market it will have a better market than it has now and than it will have if we do nothing.

Mr. Sproul concluded with the comment that he felt the Committee was being prevented by delay after delay from carrying out an effective program, that this had been the case since it adopted a policy of greater flexibility in June 1949, and that he did not feel that any exploratory committee which might be set up under the Director of Defense Mobilization could supersede or add to the knowledge that had been collected by the Open Market Committee which had been studying this matter over a period of years. Even if the results of a study of such a committee supported and confirmed the views of the Open Market Committee, Mr. Sproul said, the responsibility would still be that of the Committee and it seemed to him that the pleas

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for further delay were only wasting valuable time, when the Committee could make its policy effective without any harm to the defense program and with the hope of helping to restrain inflationary forces.

Chairman McCabe then referred to the statement submitted to the Board of Governors by the Federal Advisory Council at a joint meeting on February 20, 1951, which failed to support the policies adopted by the Federal Open Market Committee. He stated that it was difficult to understand why the members of the Federal Advisory Council would take a position so different from that taken by the Presidents of the Federal Reserve Banks and that it might be desirable to present the matter for discussion at the next meetings of directors of Federal Reserve Banks with the view to finding out what views were held by them. There was a brief discussion of this matter but no action was taken.

There followed a discussion of actions that might be taken in the light of the letter to the Secretary of the Treasury on February 7 and of the fact that the System was continuing to provide additional reserves to banks through purchases of Government securities. During this discussion, Mr. Eccles expressed doubt as to the adequacy of the program set forth in the letter of February 7, and said that in his opinion it was important that the Board of Governors be given additional authority over reserve requirements of member banks. There was a discussion of legislative proposals that might be submitted to the Congress to provide additional authority to the Federal Reserve System for increasing bank reserve requirements. Following comments

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by Messrs. Szymczak and Evans that the Federal Open Market Committee should not continue to delay action and that it should resist further suggestions for delay, the discussion indicated a unanimous view that in further discussions with representatives of the Treasury and others the Committee should continue to emphasize the urgent need for prompt action by the Federal Open Market Committee to carry its proposed policies into effect.

At the conclusion of the discussion, the meeting recessed to enable the Chairman and Mr. Sproul to attend the meeting at the White House. It reconvened at 2:15 p.m. with the same attendance as at the morning session except that Mr. R. F. Leach, Economist in the Division of Research and Statistics of the Board of Governors, also was present.

Chairman McCabe stated that he and Mr. Sproul attended the meeting with the President in the Cabinet room of the White House at 11:00 a.m. and that there were also present Mr. Wilson, Director of the Office of Defense Mobilization, Messrs. Keyserling, Clark, and Blough of the Council of Economic Advisers, Under Secretary of the Treasury Foley and Assistant Secretary of the Treasury Martin, Chairman McDonald of the Securities and Exchange Commission, Mr. Murphy, Special Counsel to the President, and Mr. Murphy's assistant. The President opened the meeting, Chairman McCabe said, by reading a memorandum addressed to the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Director of the Office of Defense Mobilization, and the Chairman of the Council of Economic Advisers. At Chairman McCabe's request, Mr. Carpenter

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read the memorandum which was as follows:

"I have been much concerned with the problem of reconciling two objectives: first, the need to maintain stability in the Government security market and full confidence in the public credit of the United States, and second, the need to restrain private credit expansion at this time. How to reconcile these two objectives is an important facet of the complex problem of controlling inflation during a defense emergency which requires the full use of our economic resources.

"It would be relatively simple to restrain private credit if that were our only objective, or to maintain stability in the Government security market if that were our only objective. But in the current situation, both objectives must be achieved within the framework of a complete and consistent economic program.

"We must maintain a stable market for the very large financing operations of the Government. At the same time, we must maintain flexible methods of dealing with private credit in order to fight inflation. We must impose restraints upon non-essential private lending and investment. At the same time, we must maintain the lending and credit facilities which are necessary to expand the industrial base for a constant build-up of our total economic strength. Instead of fighting inflation by the traditional method of directing controls toward reducing the overall level of employment and productive activity, a defense emergency imposes the harder task of fighting inflation while striving to expand both employment and production above what would be regarded as maximum levels in normal peacetime.

"What we do about private credit expansion and about the Government securities market is, of course, only a part of the problem that confronts us. A successful program for achieving production growth and economic stability in these critical times must be based upon much broader considerations.

"We must make a unified, consistent, and comprehensive attack upon our economic problems all along the line. Our program must include, in proper proportion, production expansion policy, manpower policy, tax policy, credit policy, debt management and monetary policy, and a wide range of direct and indirect controls over materials, prices and wages. All of these policies are necessary; each of them must be used in harmony with the rest; none must be used in ways that nullify others.

"We have been striving in this emergency to develop such a unified program in the public interest. Much progress has already been made, both on the production front and on the anti-inflation front. Many peacetime activities of Government, including the activities of lending and financing agencies, have been pruned

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"down. Cut-backs of civilian supplies and allocations of essential materials have been successfully undertaken. Important expansion programs for basic materials and productive capacity needed in the defense effort have been gotten underway. Price and wage controls have been initiated. Restraints on consumer and real estate credit have been applied. Large tax increases have been enacted, and additional tax proposals are now pending. In all these fields further action is being planned and will be taken as needed.

"One outstanding problem which has thus far not been solved to our complete satisfaction is that of reconciling the policies concerning public debt management and private credit control. Considering the difficulty of this problem, we should not be discouraged because an ideal solution has not yet been found. The essence of this problem is to reconcile two important objectives, neither of which can be sacrificed.

"On the one hand, we must maintain stability in the Government security market and confidence in the public credit of the United States. This is important at all times. It is imperative now. We shall have to refinance the billions of dollars of Government securities which will come due later this year. We shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year, even assuming the early enactment of large additional taxes, because of the seasonal nature of tax receipts which concentrate collections in the first half of the year, and because of the inevitable lag between the imposition of new taxes and their collection by the Treasury. Such huge financial operations can be carried out successfully only if there is full confidence in the public credit of the United States based upon a stable securities market.

"On the other hand, we must curb the expansion of private loans, not only by the banking system but also by financial institutions of all types, which would add to inflationary pressures. This type of inflationary pressure must be stopped, to the greatest extent consistent with the defense effort and the achievement of its production goals.

"The maintenance of stability in the Government securities market necessarily limits substantially the extent to which changes in the interest rate can be used in an attempt to curb private credit expansion. Because of this fact, much of the discussion of this problem has centered around the question of which is to be sacrificed--stability in the Government securities market or control of private credit expansion. I am firmly convinced that this is an erroneous statement of the problem. We need not sacrifice either.

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"Changing the interest rate is only one of several methods to be considered for curbing credit expansion. Through careful consideration of a much wider range of methods, I believe we can achieve a sound reconciliation in the national interest between maintaining stability and confidence in public credit operations and restraining expansion of inflationary private credit.

"We have effective agencies for considering this problem and arriving at a proper solution.

"Over the years, a number of important steps have been taken towards developing effective machinery for consistent and comprehensive national economic policies. One of the earliest steps in this century was the establishment of the Federal Reserve System before World War I. At that time, under far simpler conditions than those now confronting us, the Federal Reserve System was regarded as the main and central organ for economic stabilization. After World War II, in a much more complex economic situation and a much more complex framework of governmental activities affecting the economy, the Council of Economic Advisers was established by the Congress under the Employment Act of 1946 to advise the President and help prepare reports to the Congress concerning how all major economic policies might be combined to promote our economic strength and health. Still more recently, in the current defense emergency, the Office of Defense Mobilization has been established to coordinate and direct operations in the mobilization effort. In addition, some of the established departments, such as the Treasury Department, have always performed economic functions which go beyond specialized problems and affect the whole economy.

"Consequently, I am requesting the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers to study ways and means to provide the necessary restraint on private credit expansion and at the same time to make it possible to maintain stability in the market for Government securities. While this study is underway, I hope that no attempt will be made to change the interest rate pattern, so that stability in the government security market will be maintained.

"Among other things, I ask that you consider specifically the desirability of measures: (1) to limit private lending through voluntary actions by private groups, through Government-sponsored voluntary actions such as was done in a narrow field by the Capital Issues Committee of World War I, and through direct Government controls; and (2) to provide the Federal Re-

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"serve System with powers to impose additional reserve requirements on banks.

"Under the first heading, I am sure that you are aware of the efforts that are already underway by the American Bankers Association, the Investment Bankers Association, and the life insurance association. I want you to consider the desirability of this or other kinds of private voluntary action in bringing about restraint on the part of lenders and borrowers.

"I should like you to consider also the establishment of a committee similar to the Capital Issues Committee of World War I, but operating in a broader area. The objectives of such a Committee would be to prevail upon borrowers to reduce their spending and to curtail their borrowing, and to prevail upon lenders to limit their lending. The activities of this committee could be correlated with those of the defense agencies under Mr. Wilson with the objective of curtailing unnecessary uses of essential materials.

"Furthermore, I should like you to consider the necessity and feasibility of using the powers provided in the Emergency Banking Act of 1933 to curtail lending by member banks of the Federal Reserve System. These powers are vested in the Secretary of the Treasury subject to my approval. The Secretary could by regulation delegate the administration of this program to the 12 Federal Reserve Banks, each to act in its own Federal Reserve District under some flexible procedure. The program could be extended to institutions other than member banks, if desired, by using the powers provided by the Trading with the Enemy Act.

"Under the second heading, you will recall the recommendation I made to the Congress a number of times in recent years to provide additional authority for the Federal Reserve System to establish bank reserve requirements. I should like you to consider the desirability of making that or another recommendation with the same general purpose at the present time.

"You are all aware of the importance of this problem, and the need for an early resolution. I should like your study to proceed as rapidly as possible. I hope you will be able to give me at least initial recommendations by March 15. I am asking the Secretary of the Treasury to arrange for calling this group together at mutually convenient times.

"At the same time that we are working to solve this problem of maintaining the stability of the Government securities market and restraining private credit expansion, we shall, of course, continue vigorously to review Government lending and loan guarantee operations. Since the middle of last year, we have taken a series of steps to curtail such operations and limit them to amounts needed in this defense period. I am

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"directing the agencies concerned to report to me by March 15 on the nature and extent of their current activities, so that these operations may again be reviewed as part of our over-all anti-inflationary program."

Chairman McCabe said that he and Mr. Wilson knew nothing of the memorandum before the White House meeting and after the President read it and commented on various phases of it he called for a frank discussion of proposals contained in the memorandum, commenting that, while it could be issued in the form of an executive order, he would prefer not to use the authority of his office to make it a direction. Chairman McCabe also said that Mr. Clark talked first, expressing views very much in support of the Treasury position, that Mr. Sproul made an excellent presentation of the position of the Federal Open Market Committee and its responsibility, and that it was apparent from comments by Messrs. Foley and Keyserling that they knew about the memorandum before the meeting. He added that in view of Secretary Snyder's illness, the President requested Mr. Wilson to assume the Chairmanship of the Committee to make the study outlined in the memorandum and that Mr. Wilson responded that he felt the study should be made within ten days rather than by March 15 because he felt some action should be taken in order to prevent the situation from undermining the things his organization was trying to accomplish. The Chairman went on to say that he commented on the situation created by the continued purchase by the System of restricted bonds at a premium, and that his comments were followed by a statement by Mr. Foley to the effect that the proposed action by the Federal Open Market Committee might cause a crisis which

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should be avoided. There was a discussion, Chairman McCabe said, of whether the memorandum should be released and it was understood that it probably would be released with a supplementary statement by the President that there were no commitments asked for or given during the meeting.

At this point a Dow Jones ticker story was brought into the meeting which stated that the memorandum had been released to the press.

There followed a general discussion of the memorandum and of the powers that might be exercised under the Trading with the Enemy Act and the Emergency Banking Act of 1933 to regulate the business of banks and other financing institutions. During the discussion it was suggested that, in view of the fact that Mr. Wilson had been asked to assume the Chairmanship of the Committee in making the study outlined in the President's memorandum, it would be desirable to discuss with him the procedure that might be followed. It was also suggested that, even though it appeared that the program suggested in the President's memorandum would cause further delay and that there was little reason to expect that the study could contribute anything new, it would be desirable under all the circumstances to delay making a change in open market operations at least until Chairman McCabe and Mr. Sproul had discussed the matter with Mr. Wilson.

At the conclusion of the discussion, Chairman McCabe suggested that a draft of statement which might be presented to or discussed with

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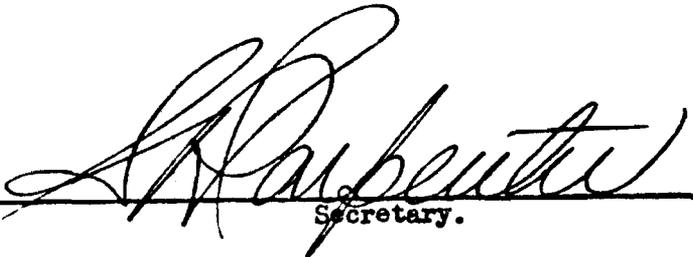
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Mr. Wilson be prepared by Mr. Sproul and such members of the staff as he should select, and that he and Mr. Sproul seek a meeting with Mr. Wilson later today if possible for the purpose of discussing the proposed study in the light of the views held by the members of the Federal Open Market Committee.

This suggestion was approved unanimously with the understanding that Chairman McCabe and Mr. Sproul should use their judgment as to whether a written statement should be left with Mr. Wilson.

Secretary's note: It was subsequently agreed by Messrs. McCabe and Sprcul that a letter should not be presented to Mr. Wilson. Chairman McCabe subsequently reported that he and Mr. Sproul met with Mr. Wilson and Mr. Weinberg, Special Assistant to Mr. Wilson, on the evening of February 26 at which time Mr. Wilson discussed how the study proposed in the President's memorandum was to be made.

Thereupon the meeting adjourned.


Secretary.