

Internal MemorandumOpen Market Committee

Supplementing memorandum from Miss Burnett to Miss Adams

The early files of the Board of Governors on the Open Market Committee are numbered 333.1. They begin in 1921, and the following items seemed to me worth noting:

A letter of November 18, 1921 from Governor Austin of the Philadelphia Bank to Governor W. P. G. Harding of the Board suggests that the Banks buy 2% government paper for income purposes. To this Governor Harding replied, "I do not think the Board would look with favor on the purchase of Liberty Bonds by Federal Reserve Banks." He does not, however, close the door to government paper, but suggests that victory notes or Treasury certificates might be more appropriate for the purpose.

In rapid succession Governor John Perrin of San Francisco (December 8, 1921), Mr. Fancher of Cleveland (December 29, 1921), Mr. Frederic Curtiss of Boston (January 3, 1922) and Mr. McKinney of Dallas (January 27, 1922) made rather similar requests.

On January 10, 1922 an internal memorandum from Mr. Smead to Mr. Mitchell of the Board explained in detail what happens when Reserve Banks buy Liberty Bonds or when they use their money to invest in buildings.

A letter of March 3, 1922 from Parker Gilbert, then Under Secretary in the Treasury, concerning the purchase by Federal Reserve Banks of government paper shows first a preference that the Treasury not be made responsible for advice in this matter, and second surprise at the "nervousness of the Banks" over their earnings.

After considerable correspondence, a letter of March 22, 1922 from the Board to all Federal Reserve Banks requested that purchases of government obligations be centralized in the New York Bank. There is no indication, or at least no

proof, in the file as to how far this was done at the request of Gilbert or after consultation between Gilbert and Benjamin Strong. A reply of Benjamin Strong to Mr. Harding dated March 22, 1922 is worthy of quotation.

On April 10, 1922 Parker Gilbert wrote to Governor Strong saying that three movements were creating cheap money and making for inflation: first, the Federal Reserve Bank investment in government ^{bonds} funds; second, the money put out by the War Finance Corporation in the past six months; and third, the tremendous inflow of gold within the past year. He asks the Federal Reserve Bank of New York to sell their government obligations, apparently in an effort to stem this flood. (This is the first indication in this correspondence that the purchase by Federal Reserve Banks of government obligations is any more than a headache to the Treasury in that it makes it seem easier for the Treasury to sell its obligations and prevents them from estimating the strength of the independent market.)

See Annual Report of Fed. (1922) p. 409 at ref.
A letter of April 25, 1922 from Mellon to Harding is still worrying over the amount of Federal obligations amassed by the Banks for the sole reason that they want to increase their earnings by the interest which these bring.

On April 26, 1922 Parker Gilbert wired to Governor Strong that the market could absorb blocks of government bonds but that he would prefer the operation by only that of the New York Bank's and that the bonds not be sold to other Federal Reserve Banks.

On April 18th a letter misplaced in these files from Governor Strong to Parker Gilbert shows a very clear intent to use purchases of government bonds in order to control interest rates "to facilitate foreign borrowing." This letter is a copy of the original and is included in explanation of a letter of April 28th from Gilbert to Strong in comment on the Strong letter. Mr. Gilbert in that letter states the discount rate to be relatively ineffective.

I could not find any record in these file of the formation of ~~THE~~ a Committee of Governors on Open Market Operations. Miss Burnett includes a citation

saying that a "Committee of Governors on Centralized Execution of Purchases and Sales of Government Securities," which would have been the first of the Open Market Committees, functioned from May, 1922 to April ¹/₁, 1923. The files of which I speak contained a notation that the Federal Advisory Council^{*} was to meet (or was this the Conference of Governors?^{**}) on April 29th, and it may have been that at that time action was taken to set up this Committee of Governors. In any event, it seems to be the actual origin of the Committee.

Related files including Conference of Governors, Board Minutes, Advisory Council recommendations, might shed further light on this detail. The Board files, which are correspondence files, are extremely interesting on the subject, but one has the feeling that they do not contain all the record of all the thinking and debate that went on.

MA:IB

* Met Apr. 28, 1922

** Met May 2-4, 1922 - set up "Committee of Governors on Centralized Execution of Purchases + Sales of Government Securities",