November 13, 1947.

Honorable C. Douglass Buck,
United States Senate,
Washington, D. C.

Dear Senator Buck:

This is in response to your letter of November 3, 1947, quoting portions of a letter from a correspondent who suggested certain courses of action by the Federal Reserve which he believes would be effective in the present situation.

It is evident that he has given unusual thought to the monetary aspects of the problem but that he may not have seen the Board's Annual Reports for 1945 and 1946 in which we reviewed the inflationary aspects of the situation which have developed since the war and the existing limitations on Federal Reserve authority. These reports outlined for legislative consideration some measures which might have corrective value. I am enclosing copies so that if you wish you may send them to your correspondent for his further study with special reference to his first proposal, relating to reserve requirements. We are hopeful that the forthcoming session of Congress will give thoroughgoing consideration to the question as to what additional powers in this field might properly be vested in the Federal Reserve System.

In this connection, I might say that it requires "compartmentalized thinking", as your correspondent put it, in order to come to the conclusion that Federal Reserve powers could be successfully used to combat the inflation. The Federal Reserve System can work toward economic stability through its influence on the flow of money but manifestly there are limitations on the effectiveness of such influence, because of the non-monetary factors affecting prices and business activity which cannot be controlled by monetary action. The goal can only be obtained through the coordination of the major policies of Government in the domestic and foreign field which influence business activity, including particularly those with respect to taxation, expenditures, foreign trade, agriculture and labor. These subjects will of course receive active consideration at the forthcoming session.

With respect to your correspondent's second proposal, that the Federal Reserve make no further purchases of Government bonds from any member bank for the purpose of enabling the member bank to increase the total of its loans and investments beyond the present level, this suggestion is predicated upon an incorrect assumption. The Federal Reserve does not make purchases for this purpose, and in practice they are not made directly from the individual member bank. They are made in the market from recognized dealers for the purpose primarily of maintaining stable conditions or of increasing the general supply of funds in the market when needed. The purpose he has in mind could only be accomplished

through some such method as those outlined in the Board's Annual Reports.

As to your correspondent's third suggestion that, if the operation of his first two suggestions did not bring the credit expansion to a halt, then the Federal Reserve should start to sell Government bonds, the adoption of such a course of action would not only create difficult market problems for the Treasury in refunding its maturing and called securities but the price declines might be so sharp that they would be seriously harmful to the holders of outstanding long-term Government bonds and might have unfavorable repercussions on the functioning of many organizations such as insurance companies, educational institutions, trust funds, and others dependent upon their investments in Government securities. It is not an altogether sufficient answer in such cases to say that they might hold their investments through to maturity. Circumstances and situations frequently arise in which they must be able to liquidate or to readjust their investments to some extent.

In this connection you will be interested in knowing that one of the results of the policy which is being followed by the Treasury in refunding maturing obligations is that through the issuance of shorter-term obligations, even though at slightly higher rates than have prevailed heretofore, there is a substantial reduction in the overall cost to the Government of carrying its debt. This is due to the fact that a large volume of maturing obligations were securities originally issued for longer terms which have carried higher rates than the short-term securities into which they are being refunded. It has not been intended that the refunding policy should have the effect of increasing the rates carried by the longer-term issues of the Government. However logical may be the reasoning advanced by your correspondent, it is not believed that the Treasury or the Congress would willingly accept the budgetary consequences of a course of action which would result in raising these rates. We must find some other way.

I am glad to have the opportunity to consider and to reply to the proposals quoted in your letter. I hope that this reply will be of some assistance to your correspondent in his further study of the problem.

With kindest personal regards,

Sincerely yours,

(Signed) M.S. Eccles

M. S. Eccles,
Chairman.

Enclosures