Mr. Thurston says this is a draft of the letter
to the President which was never given
out to the press.

The Federal Reserve System is prepared today, as the Board of Governors announced it was in December 1941, to use its powers to assure that an ample supply of funds is available for financing the defense effort and to exert its influence toward maintaining conditions in the U. S. Government securities market that are satisfactory from the standpoint of the Government's requirements.

It continues to be, as it has always been, the policy of the Federal Reserve System and of its Federal Open Market Committee to adapt credit policy to the needs and requirements of the country and of the Government. We have given unequivocable proof of this in time of war and in ~~to~~ time of peace to the extent of supporting all Treasury financing and maintaining an orderly market in Government securities, even when this did not completely coincide with what we deemed to be the full requirements of credit policy.

We have stated our policy and our program most recently in our letter to the Secretary of the Treasury dated October ___. We cannot commit ourselves further to the program of debt management recently outlined by the Secretary of the Treasury without abdicating our statutory responsibilities which require us to exert some influence over the availability and cost of bank reserves. This may well result in further changes in short-term rates and require a review of the considerations affecting long-term financing before such financing becomes possible or necessary.

Our whole endeavor goes to the heart of the Government's anti-inflationary program which, in its essence, is to maintain public confidence in the real value of the dollar and in all Government obligations. This confidence will be destroyed if inflationary pressures now so strong in our economy are not restrained by all the means at our disposal.

The crux of the problem which confronts us is this: How can we arrest the flight of money into inflation hedges? How can we curb the dangerously rising tide of credit which makes up most of the country's supply of dollars and is adding to them at an unprecedented rate? Unless confidence in sound financial management is restored and this flood of newly created dollars in the form of credit is controlled it will overwhelm whatever barriers of price, wage, and like controls we may contrive. Our concern and our responsibility is with this basic problem of bank reserves which generate and continue to generate this tide of money. It would be augmented by the program that has been announced. Interest rates are merely a reflection of this basic force. We favor the lowest rate of interest on Government securities that will not augment the tide — that will cause true investors to save and to hold Government securities instead of letting them become the basis for continued additions to the supply of money. There is no effective way of dealing with this problem that will not reflect itself in the rate structure.

The road we are now on, xxxxxxxx unable to cope with the constantly expanding volume of credit leads inevitably to inflation. As you so well stated, Mr. President, in your Economic Report this month:

> "If inflation continues to gain cumulative force, it will multiply the cost of the defense program. It will undermine production, destroy confidence, generate friction and economic strife, impair the value of the dollar, dissipate the value of savings, and impose an intolerable burden upon fixed income groups. This must not happen."

Vital as it is to tax ourselves to the limit, even a substantial budgetary surplus cannot protect us against the danger of a reckless credit inflation.

In dealing with the problem it would be a grave mistake to have the issue confused by assertions of prerogative or interpretations of statutory responsibility. It would be equally misleading to confuse what is at stake here by speaking in terms of administrative encroachment or usurpation of authority. In essence, the Federal Reserve System for the first time is being asked to pledge unqualified support to a financial program that we can only regard with the deepest apprehension. We have searched our minds most conscientiously to determine what reply we can make. It would be a great relief to us if we could abdicate our responsibilities, and in good conscience say that this is an emergency and that in such a period it is the duty of everyone to give his best advice and, if it is not followed, proceed loyally to carry out whatever decision is arrived at.

It would be equally a relief to take the position that since we cannot see eye to eye with the Administration, we resign individually and collectively so that a body can be appointed that would find it in its conscience to operate even more exactly than we have in conformity with the announced program.

Neither of these arenas of escape are open to us in view of our oaths of office.

Our oath of office requires us conscientiously to support the Constitution and the laws of the United States enacted thereunder. The Federal Reserve Act for which we are particularly responsible requires us specifically to conduct our open market operations in accordance with our best objective judgment of the requirements of the economy. The legislative history of the Federal Reserve Act, when it was originally passed in 1913, and when it was extensively revised in 1935, makes it very clear that it was the purpose of Congress on both occasions that the Open Market Committee should not operate against its best judgment to make an administrative decision effective. For us to take such a way out would, in our judgment, do violence to our oath of office.

The Federal Reserve Act as it was enacted, both in 1913 and 1935, took particular pains to insure that the members of the Board would be appointed at two-year intervals. Again the legislative history makes it plain that the object was to insure that no single administration would be able to enforce its views by appointing a majority of the Board.

Under these circumstances, we do not see how we can find a way out from the current impasse, either the road of acquiescence or the road of resignation. Either could unduly defeat the purpose of Congress in drawing the Federal Reserve Act as they did. Either would be inconsistent with our oath of office.

Congress, however, is in session. It has full power to resolve this difficulty, either through redefining the responsibilities of the Board and the Open Market Committee or by abolishing the present Board and providing for the appointment of a new Board.

We respectfully suggest that we lay this issue before the Congress.