

Governor Eccles

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 17, 1949

To Mr. Parry

Subject: Some impressions of Douglas

From Woodlief Thomas

Committee hearings

Without attempting to give a summary or to indicate all of the important questions that were raised in yesterday's hearings, this memorandum is for the purpose of pointing out a few important impressions which I gained from listening to the questions and answers.

The dilemma of monetary policy. It seems clear from the questions of Senators Douglas and Flanders and Congressman Wolcott that they are fully aware of the difficulty which the System would face in endeavoring to carry out a restrictive monetary policy in view of the large public debt. Mr. Wolcott reverted frequently to a question as to whether some means could be devised for setting aside a part of the public debt so that it could not be monetized. Senator Douglas also raised a question as to whether the large volume of Government securities held by banks (he might have mentioned by others as well) weakened the System's powers of control. Senator Flanders asked whether a situation might arise when a rise in interest rates paid by the Government would be desirable.

These questions will need some further clarification. Mr. Williams in handling them generally indicated that flexibility in open market operations would be necessary to deal with them. The implication from this is that security prices would decline. Senator Douglas wanted to know about exactly what the procedures of System open market operations would be under the circumstances. He asked how the System could sell securities when other holders would be endeavoring to sell. Mr. Williams did not explain the processes by which restraint might be exercised under these circumstances, for example, that the System might not need to sell but would only need to restrict its buying in order to exert restraint against further expansion.

Members of the Committee in this connection raised a question as to what additional legislative powers the System would need -- are there any legislative restrictions on discount rate action? -- on open market operations? Mr. Williams finally indicated that the System would need power to change reserve requirements, but he did not indicate whether this power could be used or not without lowering the prices of Government securities. He went on to indicate that the power to increase reserve requirements was complicated by the problem of nonmember banks. No reference was made by anyone to the Board's earlier proposal for a special reserve requirement as a means of immobilizing a part of the debt nor was any reference made to the possibility of issuing securities of types which would encourage firmer holding of the debt and discourage frequent selling in anticipation of possible price declines.