FEDERAL RESERVE - TREASURY CONTROVERSY

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before the
Graduate Economics Club of Yale University
New Haven, Conn. - March 20, 1951

Conclusions:

1. The economics of the particular issue
2. Public Servants in a Democracy
    a. Intellectual grasp
    b. How much can we expect of a public servant?

I. THE ISSUE: Shall we control the supply of money even though it involves changes in interest rates - or shall we maintain interest rates low even though it is necessary to expand supply of money to do it - or shall we ration credit?

A. Why a rise?

1. Cost to Government is direct
   anti-inflationary results indirect
2. Mistaken notion of cost
   1/2% x 250 bill. = $1\frac{1}{4}$ billion
   but maturity of outstanding debt
3. Argument isn't over 1/8 or 1/4% more

B. Interest rate theory

1. Marginalism versus absolutes
    (a) Idea that both savings + investment are inelastic to rates
        (1) Interest as a cost
        (2) Interest as an inducement to save
    (b) What about very large differences in level?
    (c) What is historical "evidence"?
        (1) Actual vs. virtual movements
        (2) Braking a car going down hill
2. The level of rates versus changes

   Changes influence liquidity

   Liquidity influences flow of expenditure

C. The structure of rates

1. Circumstances leading to positively inclined structure

2. Expectations of change versus certainty

   2½% for call money?

   Actual rates depend on maturities made available

D. Summary:

Authorities can either (1) control volume of reserves and lost control over price, or

(2) control prices but lost control over volume, or

(3) ration to do both

II. INSTITUTIONS AND PEOPLE

A. Precedents on governments and central banks

1. Long run

2. U.S.A.: 1941-1951

1945	Federal presses to discontinue 1/2 per cent preferential discount rate
	Treasury opposed
	Finally done April 1946
	Federal considers elimination of 3/8 per cent bill rate
1946	Federal continues to press on 3/8 per cent bill rate
1947-July	Treasury concurs on 3/8 per cent rate
	Toward end of year Board requests added reserve authority
Dec. 24	Drop in support prices on bonds
1948-Jan.	Increase in discount rates 1 → 1-1/4
Feb.	Reserve requirements ↑ 2 per cent at central reserve cities
April	Request for further reserve powers
The summer interruption	
	In view of System actions, market expected further increases in short rates
May 13	Secretary announces June and July refundings @1-1/8

June 11	Reserve requirements ↑ 2 per cent at central reserve cities
Aug.	Discount rates 1-1/4 → 1-1/2
July-Aug.	Special Session
	Restore Regulation W Reserve requirements authority increased 4 and 1-1/2 per cent
Sept. 16	Board increases reserve requirements 2 per cent on demand, 1-1/2 per cent on time
<u>1949</u>	Recession
May	Reserve requirements reduced
June 28	Statement
Aug. 22	Douglas questionnaire
Nov. 7	"Materials" volume published
Nov. 16-Dec. 7	Hearings
	Treasury announcement
	Eccles letter to Committee dated Dec. 1
	Snyder testifies Dec. 2
<u>1950</u>-Jan. 13	Douglas Committee Report
May 5	Secretary announces June and July refundings into 13-month 1-1/4 per cent notes

III. <u>CHRONOLOGY</u>

A. Status on August 18, 1950

1. Reasonable difference of opinion as to economic prospects until June 1950
2. Actions a compromise
   - (a) Rates up faster than Treasury desired
   - (b) Rates up slower than System desired
3. Treasury practice of jumping the gun e.g. May 13, 1948, and May 5, 1950 Dec. 1949 for Jan. mat.
4. June 28, 1949, declaration of independence - in recession
Douglas inquiry as to meaning of statement
5. Statement of positions
   - (a) Douglas report
   - (b) Council of Economic Advisers

B. Subsequent developments

1. Events on August 18, 1950
   - (a) Additional inflation now certain
   - (b) Government's formal position on indirect controls
   - (c) Open-Market Committee decision
   - (d) Treasury action - hoping to forestall?

   (Prospects: Limited (large) expenditures for unlimited time
   vs. unlimited expenditures for limited period)

2. Snyder press release of Aug. 21, 1950

3. System dual objective
   - (a) Make refunding a "success"
   - (b) Limit reserves
   - (c) Net results (Table p. 5)

4. Snyder Board of Trade talk Jan. 18, 1951

5. Vardaman interview - N. Y. Times, Jan. 21

6. Sproul statement, Jan. 22

7. Joint Committee Report Jan. 24, 1951
   - (a) Slanting question to economists
   - (b) Statement of 400 economists
   - (c) Keyserling pp. 48-49
   - (d) Lynch pp. 39-40

8. Eccles testimony Jan. 25

9. McCabe Phila. speech Jan. 26
   Method of Eccles vs. method of McCabe

10. Snyder hits back at money critics

11. Truman calls in Open Market Committee Jan. 31
    - (a) White House anticipates action by Open Market Committee? Why? Vardaman? American Banker

12. Truman announces "pledge" of Board Feb. 1
    - (a) Snyder "interprets"

13. Truman releases letter to McCabe thanking Committee for agreeing to support Snyder policy Feb. 2

14. Eccles releases memo of conference saying no agreement had been reached Feb. 3

15. Did Open Market write a letter to Truman? Feb. 7

16. Washington's birthday in the Senate
    - (a) O'Mahoney introduces Clark testimony
    - (b) Paul Douglas' reply

17. White House Conference and memo. Feb. 26

    (a) Creates ad hoc group to decide what Open Market Committee should do

        C. E. Wilson John Snyder
        Leon Keyserling Tom McCabe

    (b) Content and implications! of memo. Who prepared?

    (c) 10 days to 2 weeks to solve - "boxed in?"

    (d) Reaction to memo

18. Joint announcement of full accord March 3

    (a) Treasury announcement of new conversion

    (b) Martin intercession

    (c) Interpretation: Joe Livingston

19. Government securities on their own over whole range of maturities March 8

    (a) Long terms break par

20. McCabe resigns

21. Martin appointed as successor