

William McChesney Martin, Jr., Papers

Box 19/Folder 2

Series IV, Subseries E

FRB-Treasury Accord, 1951

REPORT ON CONVERSATIONS AT THE TECHNICAL LEVEL OF
TREASURY AND FEDERAL RESERVE SYSTEM REPRESENTATIVES

Participants: Treasury - Mr. Wm. McC. Martin, Jr.
Dr. George C. Haas
Mr. Edward F. Bartelt

Federal Reserve - Mr. Winfield W. Riefler
Mr. Woodlief Thomas
Mr. Robert Rouse (N.Y. Federal)

First Meeting - Tuesday, February 20, 1951, 1:00 P.M.,
beginning at luncheon in Mr. McCabe's
office.
Adjourned at 2:45 P.M. to Federal Reserve
Board Room and continued until 4:30 P.M.

Reconvened - Tuesday, February 20, 1951, 8:30 P.M.,
home of Mr. Riefler
Adjourned at 11:30 P.M.

Reconvened - Wednesday, February 21, 1951, 2:30 P.M.,
Library of Federal Reserve Building
Adjourned at 6:15 P.M.

Reconvened - Friday, February 23, 1951, 9:45 A.M.,
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Adjourned at 12:15 P.M.

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It was clearly understood by all that these were explorations at the technical level and not negotiations.

Lengthy discussion of the techniques of the Open Market Committee and the necessity for better liason between the Federal Reserve and Treasury was a part of the early discussion, and it was clear that both of us could be better informed on the thinking of the other.

Inasmuch as the Federal Reserve group had a specific proposal, approved by the Open Market Committee, in the letter of February 7 of Chairman McCabe to the Secretary, most of the discussion attempted to clarify what was intended in that letter.

The Federal Reserve group continuously asserted the unhappiness of the Open Market Committee in ~~general~~ monetization of the Federal Debt, particularly at premium prices *and they made it clear it was their intent to keep the long term issues to par.*

There was considerable discussion of the rigidities in the present market and the fact that a large amount of selling was probably because of commitments already made by insurance companies, savings banks, loan associations and the banking system, and the consequent replenishing of reserves through sales to the Federal Reserve in the open market of Government securities.

In pursuing the policy proposed in the February 7 letter, the Federal intends to withdraw support from the short term securities market and let it adjust itself around the 1-3/4% discount rate now prevailing. They felt that when these adjustments were made, a groundwork would be laid in the market which would act as a deterrent to lending and make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the refinancings which the Treasury faces in the ~~next~~ *final* six months of the

Under these conditions the

Calendar Year 1951.

Much of their argument revolves around the traditional abhorrence of the banks for borrowing from the Federal Reserve and an aggregate reduction of needed reserves, ~~as the short term rate adjusts~~ ^{to} the discount rate, ~~a governor.~~

Under considerable pressing by the Treasury group, they were willing to explore with the Committee for a period of time running thru at the most March 1951, ^{Sec. 5/} on the maintenance of the 1 3/4% discount rate, at least through December 1951, a fixed pattern of rates covering new money to facilitate Treasury planning of new money and refinancing at the levels established as a result of these adjustments. *the new levels established as a result of these adjustments.*

There was long discussion, and much of it sympathetic to a proposal advanced principally by Mr. Riefler that the Secretary announce ^{an installment retirement} a non-marketable 2-3/4% long term bond (29-1/2 years) which could be exchanged for the ^{existing and} June or December 2-1/2's, the desire being to lock these two issues up as much as possible and remove them as an important market factor. A feature of this issue might be an alternative of exchange for 1-1/2% five-year notes for those who desired ^{to cash them.} ~~more liquidity.~~ Nevertheless, the clear intent was to drop the long term issues to par and hence file out for the time being at least the issuance of any 2-1/2% bonds of longer maturity than 17 years.

At the concluding session it was suggested by the Treasury group that if the Secretary should accede to the Federal Reserve proposal with respect to the adjustment of the short term rates and ^{should decide to announce} the ~~announcement of~~ a 2-3/4% non marketable long term issue, to be exchanged for the ^{existing} ~~outstanding~~ long term issues, ^{might consider} ~~the Federal Reserve might be~~ ^{wig} to maintain the current levels in the June and December issues ^{until it was demonstrated that they would continue to require support.} In that event the F.R. & Treasury group would then reconsider the problem.

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudice the market. ^{It was} ~~his~~ hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing any further public confidence in the markets.

It was suggested by the Federal that ^{if the Treasury decided to test the} we might agree to buy two ^{new exchange} hundred million of the long terms - one hundred million by the Treasury, ^{some this} one hundred million by the Federal, and then agree to purchase another ^{up to} four hundred million - 75% or three hundred million to be purchased by the Treasury, and one hundred million or 25% to be purchased by the Federal, and when six hundred million had been purchased to re-examine the problem.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was by far the most significant psychological factor in the current situation.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal

the Treasury decided to test the new exchange some this way might be an agreement that cost of supporting the first 200 million purchased be shared equally by the Treasury and the F. Reserve, that the T. carry 75% of the cost of the exchange the Treasury 400 million and that the Treasury carry the whole amount of any purchases in excess of 600 million are required.

view that their proposal would involve no serious disruption of the security market and they ~~see~~ ^{and confident feel} ~~maintaining~~ that the increased flexibility of the market would produce more confidence.

Their major point is an unwillingness on their part to continue monetization of debt, ~~although~~ ^{maintenance of orderly markets} they concede that ~~this~~ monetization would continue, although in their ~~judgment~~ ^{with} at a reduced pace and at less cost to them if the support prices ^{entail some} were reduced. ^{further}

Under continuous questioning, there was general agreement that we were discussing degrees rather than absolutes, and the Treasury was questioning the effectiveness of the operation, and also questioning the Federal evaluation that the repercussions in the market would not be serious. ^{monetization} ^{which they} ^{would hope} ^{to keep it} ^{a minimum}

^{the F.R.}
It was clear that at least on a theoretical basis whatever consistency there was in what obviously were two essentially opposing concepts seemed along the line of either following the Federal proposal in its entirety or pursuing the course advocated by the Secretary in his January 18 address accepting the necessity of ~~some~~ further monetization of the debt during the emergency period, but attempting to minimize its effects through other means than a revision of interest rates.

At the end of the meetings it was made clear again that these were exploratory talks and that no counter proposals had been offered by the Treasury. ~~Accordingly~~, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

Both sides agreed that monetization of debt must be stopped as far as possible. The F.R. position was further that this could not be done without repercussions in the money market while the Treasury view has been that it could be minimized through direct approaches which were preferable to increases in interest rates. This was the philosophy back of the Secy's Jan 18 address, upon exploration of that address it was agreed, however, that there was nothing in the proposals discussed which ran ~~hardly~~ counter to that address. ~~The Secy was not adamant on the subject of short term rates.~~ He did not discuss an exchange issue - but such an issue at $2\frac{3}{4}\%$ if it were long term and non-marketable would not be considered inconsistent with a $2\frac{1}{2}\%$ rate on the outstanding issues.

~~through roads~~

~~relying principally on canalization~~

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February 24, 1951

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Adjourned at 12:15 p.m.

4:35 p.m. -- Cleared with Martin
Not cleared with Bartelt or Haas

It was clearly understood by all that these were explorations at the technical level and not negotiations.

Lengthy discussion of the techniques of the Open Market Committee and the necessity for better liaison between the Federal Reserve and Treasury was a part of the early discussion, and it was clear that both of us could be better informed on the thinking of the other.

Inasmuch as the Federal Reserve group had a specific proposal, approved by the Open Market Committee, in the letter of February 7 of Chairman McCabe to the Secretary, most of the discussion attempted to clarify what was intended in that letter.

The Federal Reserve group continuously asserted the unhappiness of the Open Market Committee in continual monetization of the Federal Debt, particularly at premium prices and they made it clear that it was the judgment of the Committee that the price of the long-term bonds should be permitted to drop to par.

There was considerable discussion of the rigidities in the present market and the fact that a large amount of selling was probably because of commitments already made by insurance companies, savings banks, loan associations and the banking system, and the consequent replenishing of reserves through sales to the Federal Reserve in the open market of Government securities.

Under the policy proposed in the February 7 letter, the Federal would withdraw support from the short-term securities market and let it adjust itself around the 1-3/4 percent discount rate now prevailing. They believe that once these adjustments were made, a groundwork would be laid in the

market which would act as a deterrent to lending and at the same time make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the refinancings which the Treasury faces in the final six months of the Calendar Year 1951.

Much of their argument revolves around the traditional abhorrence of the banks for borrowing from the Federal Reserve and their confidence in the restraining influence of borrowed reserves. Under these conditions short-term rates adjust to the discount rate.

Under considerable pressing by the Treasury group, the Federal Reserve group were willing to explore with the Committee the feasibility of a commitment to maintain the discount rate at $1\frac{3}{4}$ percent for a period of time running through December 1951 in order to facilitate Treasury planning of new money and refinancing at the new levels established as a result of these adjustments. It was pointed out, however, that any such advance commitment might present difficulties since it would involve all directors of all 12 Federal Reserve Banks as well as the Board of Governors.

There was long discussion, and much of it sympathetic, of a proposal advanced principally by Mr. Riefler that the Secretary announce a non-marketable $2\frac{3}{4}$ percent long-term, installment retirement, bond (29- $\frac{1}{2}$ years) which could be exchanged for the existing $2\frac{1}{2}$'s June and December of 1967-72, the desire being to lock these two issues up as much as possible and remove them as an important market factor. A feature of this issue might be an alternative of exchange for $1\frac{1}{2}$ percent five-year notes for those who desired to cash them or wanted a marketable issue.

At the concluding session it was suggested by the Treasury group that if the Secretary should offer no objection to the Federal Reserve proposal

with respect to the adjustment of short-term rates and should decide to announce a 2-3/4 percent long-term non-marketable issue, to be exchanged for the outstanding long-term restricted issues, the Federal Reserve might consider maintaining the current levels in the June and December issues until it was demonstrated whether they would continue to require support. In the event that continued support were necessary, the Treasury group suggested that the Federal Reserve and the Treasury could meet again to consider the problem.

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudge the market. It was his hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing further public confidence in the markets.

It was suggested by the Federal that if the Treasury desired to test the new exchange issue this way, they might consider an agreement that the cost of supporting the first two hundred million purchased be shared equally by the Treasury and the Federal Reserve, that the Treasury carry 75 percent of the cost of the succeeding \$400 million, and that the Treasury carry the whole amount of any purchased in excess of \$600 million.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was a most significant psychological

factor in the current situation. Both groups attached great importance to the public's fear of further loss in the purchasing power of the dollar.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal view that their proposal would involve no serious disruption of the security market. They feel that the increased flexibility of the market would produce more confidence.

Their major point is an unwillingness on their part to continue monetization of debt. They concede that maintenance of orderly markets will entail some further monetization which they would hope to keep at a minimum.

There was general agreement that we were discussing degrees rather than absolutes, and that the Treasury was questioning the effectiveness of the operation, and also questioning the Federal evaluation that the repercussions in the market would not be serious.

Both sides agreed that monetization of debt must be stopped as far as possible. The Federal Reserve position was firm that this could not be done without repercussions in the money market while the Treasury view has been that it could be minimized through direct controls which were preferable to increases in interest rates. This was the philosophy back of the Secretary's January 18 address. Upon exploration of the proposals in the light of that address, however, it was agreed that the proposals discussed did not run directly counter to that address. He did not discuss an exchange issue. Such an issue at 2-3/4 percent, if it were long-term and non-marketable, would not be inconsistent with a 2-1/2 percent rate on the outstanding marketable issues.

At the end of the meetings it was made clear again that these were only exploratory talks. Accordingly, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

Int. June 24th

REPORT ON CONVERSATIONS AT THE TECHNICAL LEVEL OF
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There was considerable discussion of the rigidities in the present market and the fact that a large amount of selling was probably because of commitments already made by insurance companies, savings banks, loan associations and the banking system, and the consequent replenishing of reserves through sales to the Federal Reserve in the open market of Government securities.

Under the policy proposed in the February 7 letter, the Federal would withdraw support from the short-term securities market and let it adjust itself around the 1-3/4% discount rate now prevailing. They believe that once these adjustments were made, a groundwork would be laid in the

market which would act as a deterrent to lending and at the same time make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the refinancings which the Treasury faces in the final six months of the Calendar Year 1951.

Much of their argument revolves around the traditional abhorrence of the banks for borrowing from the Federal Reserve and their confidence in the restraining influence of borrowed reserves. Under these conditions short-term rates adjust to the discount rate.

Under considerable pressing by the Treasury group, the Federal Reserve group were willing to explore with the Committee the feasibility of a commitment to maintain the discount rate at 1-3/4% for a period of time running through December 1951 in order to facilitate Treasury planning of new money and refinancing at the new levels established as a result of these adjustments. It was pointed out, however, that any such advance commitment might present difficulties since it would involve all directors of all 12 Federal Reserve Banks as well as the Board of Governors.

There was long discussion, and much of it sympathetic, of a proposal advanced principally by Mr. Riefler that the Secretary announce a non-marketable 2-3/4% long-term, installment retirement, bond (29-1/2 years) which could be exchanged for the existing 2-1/2's June and December of 1967-72, the desire being to lock these two issues up as much as possible and remove them as an important market factor. A feature of this issue might be an alternative of exchange for 1-1/2% five-year notes for those who desired to cash them or wanted a marketable issue.

At the concluding session it was suggested by the Treasury group

that if the Secretary should offer no objection to the Federal Reserve proposal with respect to the adjustment of short-term rates and should decide to announce a 2-3/4% long-term nonmarketable issue, to be exchanged for the outstanding long-term restricted issues, the Federal Reserve might consider maintaining the current levels in the June and December issues until it was demonstrated whether they would continue to require support. In the event that continued support were necessary, the Treasury group suggested that the Federal Reserve and the Treasury could meet again to consider the problem.

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudge the market. It was his hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing further public confidence in the markets.

It was suggested by the Federal that if the Treasury desired to test the new exchange issue this way, they might consider an agreement that the cost of supporting the first two hundred million purchased be shared equally by the Treasury and the Federal Reserve, that the Treasury carry 75 per cent of the cost of the succeeding \$400,000,000, and that the Treasury carry the whole amount of any purchased in excess of \$600,000,000.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was a most significant psychological factor in the current situation. ^{Both} ~~The Federal Reserve~~ group attached great importance to the public's fear of further loss in the purchasing power of the dollar.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal view that their proposal would involve no serious disruption of the security market. They feel that the increased flexibility of the market would produce more confidence.

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Both sides agreed that monetization of debt must be stopped as far as possible. The Federal Reserve position was firm that this could not be done without repercussions in the money market while the Treasury view

has been that it could be minimized through direct controls which were preferable to increases in interest rates. This was the philosophy back of the Secretary's January 18 address. Upon exploration of the proposals in the light of that address, however, it was agreed that ~~there~~ the proposals discussed did not run directly counter to that address. ~~(The Secretary was not adamant on the subject of short-term rates.~~ He did not discuss an exchange issue. Such an issue at 2-3/4%, if it were long-term and nonmarketable, would not be inconsistent with a 2-1/2% rate on the outstanding marketable issues.

At the end of the meetings it was made clear again that these ^{only} were exploratory talks, ~~and that no counter proposals had been offered by the Treasury.~~ Accordingly, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

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Lengthy discussion of the techniques of the Open Market Committee and the necessity for better liaison between the Federal Reserve and Treasury was a part of the early discussion, and it was clear that both of us could be better informed on the thinking of the other. The discussion brought out the high degree of cooperation which exists between the Treasury and the Federal Reserve in coordinating the function of the Treasury in maintaining its daily cash position with the function of the Federal Reserve in controlling bank reserves. It was mentioned that the Treasury consults freely with the Manager of the Open Market Account in forecasting daily and weekly cash receipts and payments and in determining the amounts of calls to be made on Treasury Tax and Loan Accounts. The Manager of the Open Market Account was commended for his courtesy in furnishing information and answering questions regarding the Market, when requested, but the view was expressed that if the Federal Reserve would consult more freely with Treasury before movements are made in the direction of changes in price levels (with consequent effects on interest rates) there would be brought about a closer coordination of the credit policy of the Federal Reserve with the debt management policy of the Treasury. Treasury mentioned, particularly, its helplessness when Open Market Policy between financing periods results in a market situation which virtually pre-determines an interest-rate change for the new financing. It was also felt that confidence is not promoted if new issues are permitted to "sour" shortly after they have been put on the Market.

Inasmuch as the Federal Reserve group had a specific proposal, approved by the Open Market Committee, in the letter of February 7 of Chairman McCabe

1/26/51 - *Partlet's suggestions underlined*

to the Secretary, most of the discussion attempted to clarify what was intended in that letter.

The Federal Reserve group continuously asserted the unhappiness of the Open Market Committee in continual monetization of the Federal Debt, particularly at premium prices and they made it clear that it was the judgment of the Committee that the price of the long-term bonds should be permitted to drop to par.

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Under the policy proposed in the February 7 letter, the Federal would withdraw support from the short-term securities market and let it adjust itself around the 1-3/4 percent discount rate now prevailing. They believe that once these adjustments were made, a groundwork would be laid in the market which would act as a deterrent to lending and at the same time make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the refinancings which the Treasury faces in the final six months of the Calendar Year 1951.

Much of their argument revolves around the traditional abhorrence of the banks for borrowing from the Federal Reserve and their confidence in the restraining influence of borrowed reserves. Under these conditions short-term rates adjust to the discount rate.

At the suggestion of the Treasury group, the Federal Reserve group indicated a willingness to explore with the Committee the feasibility of a

a commitment to maintain the discount rate at 1-3/4 percent for a period of time running through December 1951 in order to facilitate Treasury planning of new money and refinancing at the new levels established as a result of these adjustments. It was pointed out, however, that any such advance commitment might present difficulties since it would involve all directors of all 12 Federal Reserve Banks as well as the Board of Governors.

There was long discussion, and much of it sympathetic, of a proposal advanced principally by Mr. Riefler that the Secretary announce a non-marketable 2-3/4 percent long-term, installment retirement, bond (29-1/2 years) which could be exchanged for the existing 2-1/2's June and December of 1967-72, the desire being to lock these two issues up as much as possible and remove them as an important market factor. This security would not be redeemable by the Treasury prior to maturity. However, a feature of this issue might be a privilege to exchange it prior to maturity for a 1-1/2 marketable five-year note in order to take care of situations where owners subsequently might desire a security that could be sold on the market. Mr. Riefler indicated that the amortization feature of the proposed 2-3/4 percent non-marketable bond could be eliminated from the terms if on consideration by the Treasury that might be undesirable.

At the concluding session it was suggested by the Treasury group that if the Secretary should offer no objection to the Federal Reserve proposal with respect to the adjustment of short-term rates and should decide to announce a 2-3/4 percent long-term non-marketable issue, to be exchanged for the outstanding long-term restricted issues, the Federal Reserve might consider maintaining the current levels in the June and December issues until it was demonstrated whether they would continue to require support. In the event that continued support were necessary, the Treasury group suggested that the

Federal Reserve and the Treasury could meet again to consider the problem.

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudge the market, or the ability of the Treasury later in the year to sell a 2-1/2 percent security, such as a G bond or the 2-1/2 percent Investor Series type issued in the Fall of 1947. It was his hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing further public confidence in the markets.

It was suggested by the Federal that if the Treasury desired to test the new exchange issue this way, they might consider an agreement that the cost of supporting the first two hundred million purchased be shared equally by the Treasury and the Federal Reserve, that the Treasury carry 75 percent of the cost of the succeeding \$400 million, and that the Treasury carry the whole amount of any purchased in excess of \$600 million.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was a most significant psychological factor in the current situation. Both groups attached great importance to the public's fear of further loss in the purchasing power of the dollar.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not

susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal view that their proposal would involve no serious disruption of the security market. They feel that the increased flexibility of the market would produce more confidence.

Their major point is an unwillingness on their part to continue monetization of debt. They concede that maintenance of orderly markets will entail some further monetization which they would hope to keep at a minimum.

There was general agreement that we were discussing degrees rather than absolutes, and that the Treasury was questioning the effectiveness of the operation, and also questioning the Federal evaluation that the repercussions in the market would not be serious.

Both sides agreed that monetization of debt must be stopped as far as possible. The Federal Reserve position was firm that this could not be done without repercussions in the money market while the Treasury view has been that it could be minimized through direct controls which were preferable to increases in interest rates. This was the philosophy back of the Secretary's January 18 address. Upon exploration of the proposals in the light of that address, however, it was agreed that the proposals discussed did not run directly counter to that address. He did not discuss an exchange issue. Such an issue at 2-3/4 percent, if it were long-term and non-marketable, would be consistent with the pattern of a 2-1/2 percent rate as announced by the Secretary on January 18.

At the end of the meetings it was made clear again that these were only exploratory talks. Accordingly, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

REPORT ON CONVERSATIONS AT THE TECHNICAL LEVEL OF
TREASURY AND FEDERAL RESERVE SYSTEM REPRESENTATIVES

- - - - -

Participants: Treasury - Mr. Wm. McC. Martin, Jr.
Dr. George C. Haas
Mr. Edward F. Bartelt

Federal Reserve - Mr. Winfield W. Riefler
Mr. Woodlief Thomas
Mr. Robert Rouse (N. Y. Federal)

First Meeting: Tuesday, February 20, 1951, 1:00 P.M.,
beginning at luncheon in Mr. McCabe's
office.
Adjourned at 2:45 P.M. to Federal Reserve
Board Room and continued until 4:30 P.M.

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home of Mr. Riefler
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Library of Federal Reserve Building
Adjourned at 6:15 P.M.

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It was clearly understood by all that these were explorations at the technical level and not negotiations.

Lengthy discussion of the techniques of the Open Market Committee and the necessity for better liaison between the Federal Reserve and Treasury was a part of the early discussion, and it was clear that both of us could be better informed on the thinking of the other. The discussion brought out the high degree of cooperation which exists between the Treasury and the Federal Reserve in coordinating the function of the Treasury in maintaining its daily cash position with the function of the Federal Reserve in controlling bank reserves. It was mentioned that the Treasury consults freely with the Manager of the Open Market Account in forecasting daily and weekly cash receipts and payments and in determining the amounts of calls to be made on Treasury Tax and Loan Accounts. The Manager of the Open Market Account was commended for his courtesy in furnishing information and answering questions regarding the market, when requested, but the view was expressed that if the Federal Reserve would consult more freely with Treasury before movements are made in the direction of changes in price levels (with consequent effects on interest rates) there would be brought about a closer coordination of the credit policy of the Federal Reserve with the debt management policy of the Treasury. Treasury mentioned, particularly, its helplessness when Open Market Policy between financing periods results in a market situation which virtually pre-determines an interest-rate change for the new financing. It was also felt that confidence is not promoted if new issues are permitted to "sour" shortly after they have been put on the Market.

The Federal Reserve group emphasized the desirability of keeping the Treasury fully informed of all open market operations and the reasons for them.
The Manager of the account supplies the Treasury with regular market reports

given to the Board and members of the Open Market Committee and also keeps the Treasury staff currently informed of operations. The Manager is glad to answer any questions that may be raised by the Treasury as to operations and objectives of policy. The Federal Reserve group are of the opinion that all operations have been conducted on the basis of and within the limits of policies previously determined by the Committee and communicated to the Secretary of the Treasury. They feel that any misunderstanding that might have risen in the past might be avoided through closer staff contact of the type contemplated for the future.

Inasmuch as the Federal Reserve group had a specific proposal, approved by the Open Market Committee, in the letter of February 7 of Chairman McCabe to the Secretary, most of the discussion attempted to clarify what was intended in that letter.

The Federal Reserve group continuously asserted the unhappiness of the Open Market Committee in continual monetization of the Federal Debt, particularly at premium prices and they made it clear that it was the judgment of the Committee that the price of the long-term bonds should be permitted to drop to par.

There was considerable discussion of the rigidities in the present market and the fact that a large amount of selling was probably because of commitments already made by insurance companies, savings banks, loan associations and the banking system, and the consequent replenishing of reserves through sales to the Federal Reserve in the open market of Government securities.

Under the policy proposed in the February 7 letter, the Federal would withdraw support from the short-term securities market and let it adjust itself around the 1-3/4 per cent discount rate now prevailing. They believe that once these adjustments were made, a groundwork would be laid in the market

which would act as a deterrent to lending and at the same time make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the refinancings which the Treasury faces in the final six months of the Calendar Year 1951.

Much of their argument revolves around the traditional abhorrence of the banks for borrowing from the Federal Reserve and their confidence in the restraining influence of borrowed reserves. Under these conditions short-term rates adjust to the discount rate.

At the suggestion of the Treasury group, the Federal Reserve group indicated a willingness to explore with the Committee the feasibility of a commitment to maintain the discount rate at $1\frac{3}{4}$ per cent for a period of time running through December 1951 in order to facilitate Treasury planning of new money and refinancing at the new levels established as a result of these adjustments. It was pointed out, however, that any such advance commitment might present difficulties since it would involve all directors of all 12 Federal Reserve Banks as well as the Board of Governors.

There was long discussion of the possibility of offering in exchange for the outstanding longest-term restricted bonds a new issue of a type that would lock funds in and remove these bonds as disturbing market factors. Particular attention, generally sympathetic, was given to a proposal advanced principally by Mr. Riefler that the Secretary announce a non-marketable $2\frac{3}{4}$ per cent long-term, installment retirement, bond (29- $1\frac{1}{2}$ years) which could be exchanged for the existing 2- $1\frac{1}{2}$'s of June and December of 1967-72. This security would not be redeemable by the Treasury prior to maturity. However, a feature of this issue might be a privilege to exchange it prior to maturity for a 1- $1\frac{1}{2}$ marketable five-year note in order to take care of situations

where owners subsequently might desire a security that could be sold on the market. Mr. Riefler indicated that the amortization feature of the proposed 2-3/4 per cent non-marketable bond could be eliminated from the terms if on consideration by the Treasury that feature might be considered undesirable.

At the concluding session it was suggested by the Treasury group that if the Secretary should offer no objection to the Federal Reserve proposal with respect to the adjustment of short-term rates and should decide to announce a 2-3/4 per cent long-term non-marketable issue, to be exchanged for the outstanding long-term restricted issues, the Federal Reserve might consider maintaining the current levels in the June and December issues until it was demonstrated whether they would continue to require support. In the event that continued support were necessary, the Treasury group suggested that the Federal Reserve and the Treasury could meet again to consider the problem.

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudge the market, or the ability of the Treasury later in the year to sell a 2-1/2 per cent security, such as a G bond or the 2-1/2 per cent Investor Series type issued in the Fall of 1947. It was his hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing further public confidence in the markets.

It was suggested by the Federal that if the Treasury desired to test the new exchange issue this way, they might consider an agreement that the cost of supporting the first two hundred million purchased be shared equally by the Treasury and the Federal Reserve, that the Treasury carry 75 per cent of the cost of the succeeding \$400 million, and that the Treasury carry the whole amount of any purchased in excess of \$600 million.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was a most significant psychological factor in the current situation. Both groups attached great importance to the public's fear of further loss in the purchasing power of the dollar.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal view that their proposal would involve no serious disruption of the security market. They feel that the increased flexibility of the market would produce more confidence.

Their major point is an unwillingness on their part to continue monetization of debt. They concede that maintenance of orderly markets will entail some further monetization which they would hope to keep at a minimum.

There was general agreement that we were discussing degrees rather than absolutes, and that the Treasury was questioning the effectiveness of the operation, and also questioning the Federal evaluation that the repercussions in the market would not be serious.

Both sides agreed that monetization of debt must be stopped as far as possible. The Federal Reserve position was firm that this could not be done without repercussions in the money market while the Treasury view has been that it could be minimized through direct controls which were preferable to

increases in interest rates. This was the philosophy back of the Secretary's January 18 address. Upon exploration of the proposals in the light of that address, however, it was agreed that the proposals discussed did not run directly counter to that address. He did not discuss an exchange issue. Such an issue at $2\frac{3}{4}$ per cent, if it were long-term and non-marketable, would be consistent with the pattern of a $2\frac{1}{2}$ per cent rate as announced by the Secretary on January 18.

At the end of the meetings it was made clear again that these were only exploratory talks. Accordingly, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

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It was clearly understood by all that these were explorations at the technical level and not negotiations.

Lengthy discussion of the techniques of the Open Market Committee and the necessity for better liason between the Federal Reserve and Treasury was a part of the early discussion, and it was clear that both of us could be better informed on the thinking of the other.

Inasmuch as the Federal Reserve group had a specific proposal, approved by the Open Market Committee, in the letter of February 7 of Chairman McCabe to the Secretary, most of the discussion attempted to clarify what was intended in that letter.

The Federal Reserve group continuously asserted the unhappiness of the Open Market Committee in continual monetization of the Federal Debt, particularly at premium prices.

There was considerable discussion of the rigidities in the present market and the fact that a large amount of selling was probably because of commitments already made by insurance companies, savings banks, loan associations and the banking system, and the consequent replenishing of reserves through sales to the Federal Reserve in the open market of Government securities.

In pursuing the policy proposed in the February 7 letter, the Federal intends to withdraw support from the short term securities market and let it adjust itself around the 1-3/4% discount rate now prevailing. They felt that when these adjustments were made, a groundwork would be laid in the market which would act as a deterrent to lending and make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the refinancings which the Treasury faces in the next six months of the

Calendar Year 1951.

Much of their argument revolves around the traditional abhorrence of the banks for borrowing from the Federal Reserve and an aggregate reduction of needed reserves as the short term rate adjusts on the discount rate as a governor.

Under considerable pressing by the Treasury group, they were willing to undertake for a period of time running thru at the most March 1952, or at least through December 1951, a fixed pattern of rates covering new money and refinancing at the levels established as a result of these adjustments.

There was long discussion, and much of it sympathetic to a proposal advanced principally by Mr. Riefler that the Secretary announce a non-marketable 2-3/4% long term bond (29-1/2 years) which could be exchanged for the June or December 2-1/2's, the desire being to lock these two issues up as much as possible and remove them as an important market factor. A feature of this issue might be an alternative of exchange for 1-1/2% five-year notes for those who desired more liquidity. Nevertheless, the clear intent was to drop the long term issues to par and hence rule out for the time being at least the issuance of any 2-1/2% bonds of longer maturity than 17 years.

At the concluding session it was suggested by the Treasury group that if the Secretary should accede to the Federal Reserve proposal with respect to the adjustment of the short term rates and the announcement of a 2-3/4% long term issue, to be exchanged for the outstanding long term issues, would the Federal Reserve undertake to maintain the current levels in the June and December issues?

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudge the market, and his hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing any further public confidence in the markets.

It was suggested by the Federal that we might agree to buy two hundred million of the long terms - one hundred million by the Treasury, one hundred million by the Federal, and then agree to purchase another four hundred million - 75% or three hundred million to be purchased by the Treasury, and one hundred million or 25% to be purchased by the Federal, and when six hundred million had been purchased to re-examine the problem.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was by far the most significant psychological factor in the current situation.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal

view that their proposal would involve no serious disruption of the security market and they seem to be contending that the increased flexibility of the market would produce more confidence.

Their major point is an unwillingness on their part to continue monetization of debt although they concede that this monetization would continue, although in their judgment at a reduced pace and at less cost to them if the support prices were reduced.

Under continuous questioning, there was general agreement that we were discussing degrees rather than absolutes, and the Treasury was questioning the effectiveness of the operation, and also questioning the Federal evaluation that the repercussions in the market would not be serious.

It was clear that at least on a theoretical basis whatever consistency there was in what obviously were two essentially opposing concepts seemed along the line of either following the Federal proposal in its entirety or pursuing the course advocated by the Secretary in his January 13 address accepting the necessity of some further monetization of the debt during the emergency period, but attempting to minimize its effects through other means than a revision of interest rates.

At the end of the meetings it was made clear again that these were exploratory talks and that no counter proposals had been offered by the Treasury. Accordingly, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

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Article Title: From A Survey of International Banking: Flexible Money in the United States

Journal Title: The Economist

Date: November 20, 1954

(Draft February 5, 1951)

Statement Re Program for Curtailment of Nonessential Bank
Credit (February 1951)

No tax program could be successful under current conditions, unless it were supported by restrictive monetary and credit policies. Deficit financing is no answer. The demand for credit continues to mount relentlessly because of unusual opportunities for profit, fear of the future (including rising interest costs), and defense needs.

The Federal Reserve and the Treasury have the power and the machinery between them to establish whatever interest rates are deemed wise. Under normal circumstances, open market operations of the Federal Reserve might penalize banks sufficiently to deter expansion of credit. But in a period of national emergency, one is justified in questioning the traditional techniques of the market and calling upon the banking system to police itself through resort to voluntary restrictions.

Curtailment of credit in accord with our agreed objectives is one of the most effective means of preserving the value of the dollar and maintaining the independence of the banking system.

In a column in the Washington Post for February 8, 1951, Mr. Walter Lippmann presents the Federal Reserve case with respect to the present interest rate controversy.

This case is as follows: We have had a serious inflation since last June. This inflation was caused by "the compulsory manufacture of money in the Federal Reserve System in order to buy those Government securities which the Treasury insisted must be bought at a fixed price." After noting the rise in demand deposits between April and December and the price rise occurring at the same time, Mr. Lippmann concludes "This is about as clear a case of purely monetary inflation as one can find."

We have here a clear statement of the Federal Reserve charge. There has been a monetary inflation says the Federal Reserve. This was caused by the Treasury insisting that the Federal Reserve buy Government securities at a fixed price.

To say that the purchase of Government securities caused inflation is to mistake form for substance -- and in addition to miss the main part of the form.

Inflation was caused by a rush to buy inventories -- to beat the price rise -- to get in ahead of the other fellow -- to expand before controls clamped down. To do these things business concerns and individuals needed credit. Some of the buying could be done with cash. But credit was needed too. A lot of it.

They got credit -- \$ ^{nearly 8} billion of new ^{commercial loans} bank credit between June and December; \$ ^{nearly 2} billion of consumer credit -- despite the new restrictions in this area.

Let's take the bank credit. That is mainly what the Federal Reserve is talking about.

The first decision on creating bank credit comes from the banker. He has to decide to make the loan or not make it. The point of contact between the banker and the businessman is a crucial part of the credit process. But let us pass on from there. Let us say the banker grants the loan. The businessman has his money -- and goes out to use it.

We are staying with the bankers in examining the credit process. He is increasing the demand deposits on the books of the bank. How does he get the necessary new reserves to cover these deposits?

He used to get them by borrowing from the Federal Reserve Bank -- the central bank. The price he paid -- the rate charged him -- was called the discount rate. It was put up, or put down, on the theory that a higher rate could discourage borrowing during inflationary periods, and that a lower rate could encourage loan applications during deflationary periods.

This theory stems from an England of long ago. It had no application -- it never worked -- in the dynamic American economy during periods of dynamic change. It only seemed to work when both the economy and the volume of credit were relatively static.

During boom periods -- the post World War I boom -- the 1929 boom -- higher rates didn't work at all. People went right on borrowing. The price of credit didn't matter, when a 100 percent or a 1,000 percent profit was the glittering goal.

At the depths of the depression, it didn't work either. The price of credit couldn't get low enough to start businessmen borrowing -- to stimulate

expansion -- when business activity was shrinking, when consumer markets were lifeless.

It doesn't take a financial expert to understand these things. They are perfectly obvious, when we get away from big words, from high sounding phrases, and look at the facts. The facts are simple, ordinary, a part of everyday experience.

The only strange thing is that, in the face of these facts, the theory persisted. It still persists. More than that, it has been given new life by the insistence of the Federal Reserve that discouraging or encouraging borrowing by means of changes in the interest rates must be true. The theory must be true, the Federal Reserve insists, because it ought to be true. Higher prices ought to discourage purchases -- of credit or of other things. Slightly higher prices ought to discourage purchases a little. Very much higher prices ought to discourage purchases a lot. But as every one knows this doesn't happen when the purchases are greatly desired or hold out the possibility of big profits. As we have noted, higher prices for credit didn't stop borrowing in 1920, in 1929. Lower prices didn't start up borrowing in 1932. But, says the Federal Reserve, they should have.

Now, let us get back to the present, to right now. We are in one of the most dynamic periods in our history. The economy has to grow. It has to provide for tremendously increased defense needs. It has to provide essential civilian goods -- enough to maintain the working efficiency of our population, over a long pull, not just a swift peak effort. Let us get away from the economist phrase "inflationary pressures". Prices are going up, are pressing up, because the different groups in our competitive free enterprise economy

are striving to push ahead, to expand before controls, to get hold of scarce materials, to build up inventories. As you see -- I come back to these essential facts in the present situation.

Now, for the theory that higher interest rates can have a decisive effect in inducing borrowers not to borrow, and bankers not to lend -- in holding back prices from jumping ahead. Let me borrow from a leading financial journal, one of our most sober, for a phrase to sum up the appropriateness of this theory. According to comment in this journal, an attempt to turn back the forces making for higher prices at the present time by means of putting up the price of credit would be like a slap on the wrist of a charging gorilla. I cannot improve on that summary of the situation.

But in order to stay with the essential facts of the situation, let us get back to the banker. He has made the loan. Let's say he made it at 4 percent. He might have asked a lot more and got it, the way things are today. That's what he did in 1929. But now he has made the loan. Both he and his customer will make money -- plenty of it -- under present rates. They made money, a great deal of it, last year -- on the basis of prevailing loan rates. Corporation profits were the highest in history. Bank profits are phenomenal.

The banker has made his loan. Now he has to increase his reserves to take care of it. Since World War II, he has not had to borrow from the Federal Reserve in order to do this. The discount rate -- whether it is high or low -- is of little interest to him. As a consequence of World War II financing, commercial banks own \$61 billion of Federal securities. These securities are a part of their earning assets. In fact, they represent one-half of them. But Federal securities do not earn as much as private loans.

When a profitable loan is in view, the banks can sell Federal securities in order to get the money for making the loan. This simply means the exchange of one earning asset for another and more profitable one. Because of their large Federal security holdings -- a legacy of World War II -- that is what the banks do nowadays when they need more loan funds. They sell Federal securities.

The Federal Reserve says that it wants to stop bank credit from going up. It wants to stop that transaction we first talked about -- the loan which the banker makes to his customer. But how does the Federal Reserve want to do this? It wants to stop this transaction by lowering slightly the price which banks get for Federal securities when they sell them. This would cause the bank to pay more -- just a little more -- for the funds they need to make loans to their customers.

This process is absolutely ineffective for the purpose intended. It never worked in the past when the discount rate reflected the price of the money needed by banks to make new loans. It hasn't worked now, when the Federal Reserve has had to put its theory into effect by going into the markets for Federal securities and altering the price structure for such securities.

Since last June the Federal Reserve has gone ahead unchecked in a policy of doing just that -- of lowering Federal security prices as a means of increasing the price which banks must pay for new funds to loan out to their customers. But what has happened during this period?

Two things have happened. First, banks have not stopped making loans. Bank credit has gone up by \$___ billion since last June -- an increase unprecedented in any similar period in our history. This is the first thing

that has happened during the period when the Federal Reserve was putting its theory into effect.

But while this theory was being proved utterly useless as a means of inflation control, it was having other and more serious consequences. The attack the Federal Reserve System on the prices of Government securities was succeeding in ^{weakening} undermining the confidence of investors in the securities of their Government. It was driving important numbers of Federal security owners out of the market -- causing them to turn their holdings into cash or to refrain from putting new funds into new Government securities. It was having exactly the opposite effect than that intended by the Federal Reserve, namely, to cause investors to hold on to their Federal security holdings. It was causing unsettlement and disturbance throughout the entire debt structure of the Government -- and this at a time when we must build up our defenses, financial and otherwise, for new tasks and new demands of unforeseeable extent and magnitude. As the result of Federal Reserve manipulations in the market -- let us remember, with the sole justification of a theory which had been proved ineffective many times in the past -- the two important refunding operations of the Government between last June and the present time were failures. People didn't want to refund their Federal securities -- they didn't want new ones. The amount of maturing issues which were turned in for cash or dumped in the market by private investors were of a magnitude unknown during World War II days. They were of a magnitude unknown during the entire postwar period. People were getting out of Federal securities. That was the effect of the Federal Reserve action.

The only result of such operations, if allowed to continue, will be that the Treasury will have to resort to the banks to a greater and greater extent

for the funds it needs. Nothing could be more inflationary. Nothing could cause more harm to our economy and to the entire defense effort. Credit must be controlled. Price rises must be checked. We have effective measures for doing this -- measures which bring in their train no harmful consequences to the economy. Raising the price of credit won't do it.

Credit is an essential commodity like steel. We have to be sure that the defense producers get it. We have to be sure that those who don't need it don't get it. Those who need credit least -- speculative buyers -- inventory hoarders -- producers of soon to be scarce consumer goods -- will pay the most for it. They will not be deterred by interest charges which are 1 percent, 2 percent, 10 percent higher or even 30 percent higher, as in 1929. And if at the same time, this futile process -- this futile slap on the wrist of a charging gorilla -- undermines the credit of the United States, forces Federal security owners out of the market, makes necessary refunding operations of the Government a failure, and drives the Government ever closer to inflationary financing -- then surely it is time to call a halt to theory. It is time to recognize the essential facts in the vital problem of inflationary control and act on the basis of these facts.

These things we must do. First, we must have comprehensive programs for allocating scarce materials and we must take the other necessary steps for reducing the incentives to speculative projects.

Having done this, we must, second, keep the volume of private borrowing at a minimum, through measures which act at the crucial point of the borrowing relationship between the banker and his customer. Selective credit controls such as those already put into effect -- voluntary credit control programs such

as those used effectively by the American Bankers Association in 1948 are of the greatest importance. Other measures for reducing the availability of credit to nonessential borrowers may be required.

Third, we must keep the volume of public borrowing at a minimum through increasing our taxes along with our increased defense needs.

Fourth, we must manage our outstanding public debt in such a way as to keep the inflationary potential at a minimum. This means keeping the largest possible proportion of the debt in the hands of nonbank investors, and keeping the bank holdings of Federal securities at the lowest possible figure. A Federal security which a commercial bank does not have is a Federal security which it cannot cash in in order to get funds for making new private loans. Any policy which leads to increasing the dependence of the Treasury on the banks and decreasing the volume of Federal securities in the hands of nonbank investors is to the highest degree inflationary. It is to the highest degree dangerous to the ability of our economy to move ahead swiftly and surely in its great task of protecting and strengthening our defenses against aggression.

I am very happy to have this opportunity of appearing before the Banking and Currency Committee in order to discuss with you the problems involved in the management of the Nation's finances.

The responsibility for the sound conduct of the Nation's finances is a very grave one. Since the earliest days of our history, this responsibility has been placed with the Secretary of the Treasury. But the problems involved are not my problems alone. They are not the problems of the Congress alone. They are the problems of every citizen of this Nation.

Here is the situation as I see it. We have today a public debt amounting to over \$250 billion. Not long ago we were worrying about a debt which might reach \$50 billion. We did not know how the country would be able to stand such a debt. We did not know how it would affect the solvency of the Government. We did not know how it could be managed without disrupting the financial life of the Nation.

But today we have a debt more than five times that figure. It is the most important single factor in our financial structure. It represents one-half of all the debt obligations in the country. Mortgages, state and municipal securities, corporate bonds, and other private obligations — all of them added together only equal the sum total of the present debt of the Government.

Life insurance companies now own over \$13 billion of Federal Government securities — about one-fifth of their total assets. Mutual savings banks own \$11 billion — about one-half of their total assets. Nonfinancial corporations own \$20 billion, or nearly 15 percent of their current assets. Individuals own \$67 billion of Federal securities of all kinds — representing approximately one-third of their total liquid assets of more than \$200 billion.

Commercial banks hold more than \$61 billion — representing approximately one-half of their earning assets.

Before World War II, the situation was entirely different. Financial institutions and business concerns had much more of their invested funds in private obligations. Only a very small proportion of our individual citizens were owners of the securities of their Government.

After World War II, the public debt was in a predominant position in the financial life of the Nation. The size, the importance, and the wide distribution of the debt are new facts to all of us. They create new problems. They place tremendous new responsibilities on the Secretary of the Treasury who is charged by law with the sound management of the Nation's finances. And under present conditions of international crisis and rising inflationary pressures, both the problems and the responsibilities are enormously increased.

Throughout the postwar period, as I have emphasized, the public debt was the most important single factor in the financial life of the Nation. But it has not been a disruptive factor. The problems involved in managing a public debt of over \$250 billion are unprecedented. But they have been successfully solved. During the postwar period the debt has been managed in such a way as to ease the problems of reconversion and promote our return to peacetime activity at the highest level of production and employment in history.

How was this accomplished? It was accomplished by placing the largest possible proportion of Federal securities in the hands of nonbank investors and reducing bank holdings of Government obligations.

The Treasury has been eminently successful in this program. During the past three years alone, bank holdings of Federal securities were reduced by nearly \$9 billion and in the last half of 1950 reached a postwar low. Correspondingly,

in 1950 nonbank holdings reached a new postwar high. This shift in ownership is of the greatest significance at the present time, since it acts directly on the money supply by reducing the inflationary potential of bank assets.

These results could not have been achieved if our people had not had full confidence in the credit of the Government. They could not have been achieved if the citizens of the Nation had not had full confidence in Government securities — and acted on that belief.

Now, it is more important than ever before that people hold on to the Government securities which they now own. It is more important than ever before that they add to these holdings as their funds permit them to do so.

How can we accomplish this end? How can we induce our citizens to hold on to their investments in Government securities and to buy more?

As I see it, we must accomplish this end just as we would with any other piece of merchandise. We must stabilize the prices. We must eliminate the fear that the owner or prospective buyer of an obligation of the Government is going to be penalized ~~financially~~ ^{during this period of emergency} by having the market price of his investment drop. Nobody wants to hold on to a commodity that is going down — that is being priced lower all the time.

I am not sure that there is general public understanding of the fact that forcing up the interest rates on Federal Government securities means forcing down the price. It means slicing off a part of the investment which every owner of a marketable security has made in the obligations of the Government. It means that owners of demand obligations, such as savings bonds, may decide it is prudent to cash in their bonds — to get their money out. There is little inducement in holding on to a fixed income obligation, like savings bonds, when other holders of Government securities are getting increasingly higher returns.

Let me repeat again -- nobody wants a commodity that is going down in price. It is imperative that we keep the securities of the Federal Government attractive to owners and purchasers. It is imperative, therefore, that we keep the prices of these securities stable. We must avoid every action which holds the risk of starting a rumor, a belief, or a fear that investment in Federal securities is not a good investment -- now or in the future.

These considerations are urgent at all times. With a Federal debt of over \$250 billion, interwoven throughout the financial fabric of the Nation, we cannot afford to raise doubts as to the wisdom or prudence of an investment in Federal Government securities. Under present circumstances, however, when our national survival demands a greatly enlarged defense program -- a program the duration of which none of us can predict -- the considerations calling for a stable and confident situation throughout the whole broad structure of the public debt are magnified many times.

Because of the uncertainties of the international situation, we cannot foresee the full extent of the financial demands which may be made upon the Government. We know only that they will be very large. The Congress has already acted to increase the revenues of the Government. Further measures for a greatly increased revenue program are now being deliberated. I am faced with the fact, however, that on the basis of present legislation, we must expect a budget deficit of approximately \$15 billion during the last three quarters of the present calendar year. In the absence of new taxes, deficit financing will therefore be required after the seasonally high tax collections of March of this year. To the extent that additional revenue is not at hand to cover all of the Government's needs, we shall have to borrow. We shall have to increase our already large public debt.

Under any circumstances, however, there appears to be no possibility, for some time to come, of reducing the outstanding debt of the Government. This means that maturing obligations which come due must be refunded. Every holder of a maturing issue may, of course, obtain cash for his securities at the time they come due. But the money to pay him will, in turn, have to be borrowed from someone else. During the remainder of this calendar year, for example, over \$50 billion of marketable securities alone must be refunded. This in itself is a tremendous financing operation. It cannot be conducted successfully without full confidence of the holders of the maturing obligations in the desirability and the wisdom of continuing their investment in securities of the Government.

These are the considerations which I must weigh if I am to fulfill my responsibilities for the sound conduct of the Nation's finances. In my view, they cannot be overemphasized. Doubts as to the wisdom of investing in securities of the Government would lead to conditions of ^{grave} financial ^{uncertainty} ~~stress~~. If these questions and doubts persisted to the point where important numbers of Federal security owners attempted to liquidate their holdings, irreparable harm would be done to the entire financial structure of the Nation. Faced with these facts and the tremendous public responsibilities placed upon me as Secretary of the Treasury, I cannot experiment with theories. I cannot stand back ^{and submit to} ~~while~~ a course of action ~~which~~ ^{represents an experiment} which holds the risk of endangering the financial functioning of our Government and disrupting the financial life of the country at a time when we must move swiftly, confidently, and surely in building up the defenses of our Nation.

The Federal Reserve has been pursuing a course of action during this period of international crisis which ^{represents an experiment} ~~involves~~ precisely this risk. The

Federal Reserve has carried on a policy which has resulted in lowering substantially the prices of outstanding issues of Government securities. The stated purpose of this program is to check credit expansion by raising interest rates.

~~[First and foremost,]~~ this program is dangerous because it takes the grave risk of upsetting the debt structure of the country -- not only the debt structure of the Government itself, but the private debt structure as well. This would involve all of the difficulties which I have previously discussed.

With a debt of the size and importance that ours is now, even a moderate increase in interest rates -- with the corresponding decline in the prices of outstanding Government securities -- would have the most serious consequences. It would hold the risk of initiating in this country a kind of inflation with which we are not familiar -- namely, a flight from the money of the country. We have never had in this country an intensive flight from the dollar. Never have people, throughout the whole country, rushed to buy real property and other tangible assets because they feared that their Government was not going to be strong enough to protect the value of its money and maintain confidence in its credit. If, however, we permit interest rates to rise so that the outstanding debt obligations of the Federal Government continuously sell at declining prices, the result overnight would be to ~~seriously discredit~~ ^{throw doubts on} the ability of the Government to protect its financial position. This could well cause wholesale liquidation of Government security holdings, in order to invest the proceeds in goods, such as refrigerators, electric freezers, television and radio sets, other electric appliances, automobiles, real estate, and a host of other things. This is exactly what

we are trying to avoid. We are trying to encourage people to save and put their money into Government securities, in order to prevent them from buying unnecessary goods -- particularly those in scarce supply -- since such purchases at a time like this, when a large portion of the country's production is being diverted to military needs, could only result in pushing the price of those goods higher.

I ask why we should take such a risk; why we should even consider actions which might impair the credit of the Government of the United States. Even if the expansion of bank credit could be completely stopped by this method, it still does not seem ^{wise} ~~rational or reasonable~~ to use this ^{particular} ~~weapon~~, knowing, as we do, the risk which it involves. Why -- at a time when it is possible to maintain the Government bond market at a level permitting new issues to be offered at no change in interest rates -- should we use a weapon which lowers the price of the outstanding securities of the Government, seriously unsettles the Government bond market, and raises doubts which, if not quelled, could impair the Government credit?

[In the second place, even if bank credit expansion were completely restricted, the battle against inflation would not have been won. The present inflation is not fed only by bank credit expansion. There have been recent periods when there has been no expansion in the money supply and yet the price level has advanced; there have been other periods when the price level stood still, although the money supply was growing. This has, in fact, been true to some extent since the Korean crisis started. One of the vitally important factors in today's economy is the huge volume of liquid assets in the hands of individuals and business concerns. These assets are "near-money". This means that we can completely stop the expansion in the money supply and

still have a huge volume of purchasing power which might be brought into play to push up prices.]

~~Why then should we use changes in the interest rate ~~and~~ to combat inflation?~~

offered by the Federal Reserve System
The ~~short~~ answer to this question is that, in time of inflationary ~~pressures~~, we must use all of the weapons at our disposal. It does not seem to me that this theory is appropriate. *It is my considered judgment, and this is the crux of the matter, that it would be a terrible mistake for this country to enter, at this critical juncture, into interest rate experiments that have the more harm than they do good.* The Federal Reserve interest rate program is open to this very objection, namely that it may deal a major blow to public confidence in the credit of the Government without any guarantee that it would be *effectively checked* ~~opposed to the Federal Reserve policy because it has not been proved that~~ ~~this~~ is an effective measure in restraining bank loan expansion and in fighting inflation. *under prevailing circumstances*

The record of recent months clearly shows that the Federal Reserve actions in increasing interest rates have had no perceptible effect on credit expansion. Total loans of all banks expanded nearly \$8 billion in the last six months of 1950 — an increase of a magnitude which has never been equalled in this country. We have had other ~~past~~ examples of attempts to control bank credit expansion by interest rate increases in the past history of our country. In the 1919-1920 inflationary period, rates on short-term Treasury issues were run up sharply until they reached nearly 6 percent; and the rate on call-money went as high as 30 percent. In 1929, rates on short-term Treasury issues were run up to above 5 percent; and the call-money rate went to 20 percent. Yet, bank credit expansion was not effectively checked

until we had the market crashes with which all of us are familiar.

The demonstrable results of the Federal Reserve actions in raising interest rates are those which affect the stability of the Government security market and confidence in the credit of the United States. The Government security market has ^{already} been seriously unsettled; and the resulting fear has restrained investors from purchasing or holding on to Government obligations. The actions of the Federal Reserve System also have brought about two failures in Treasury refunding operations. Finally, the confusion and fear with respect to the prices and yields of Government securities may even have weakened the appeal of savings bonds. During the last part of 1950, there was a noticeable decrease in the sales of the larger denomination savings bonds and an increase in redemptions of these denominations, which are ordinarily bought by the more "sophisticated" investors.

These are the controlling factors in my opposition to increases in interest rates on Government securities.

There is, however, another sure effect of the Federal Reserve actions in raising interest rates which I cannot ignore. I refer to the increase in Government expenditures which will be required to pay for the higher interest rates which we are now forced to pay upon new issues of Government securities. The Treasury is often quoted as being only concerned with this one aspect of increased interest rates. I ^{hope} ~~am sure~~ that I have made it quite clear to you today that this is not the case. Nevertheless, it is the Treasury's responsibility to recommend fiscal policy which will use the taxpayers' money wisely. There is never any defense for needless increases in taxes. I am sure that you agree with me that to use the taxpayers' money to pay for further increases in the interest cost of the public debt in an ineffectual attempt to control inflation is clearly unjustifiable.

I believe it would be helpful to you in understanding the effects of the Federal Reserve's actions in raising interest rates on Government Securities, if I spent a few minutes now discussing more specifically what has happened in the Government security market since the invasion of the Republic of Korea.

As soon as I received the news of the Korean crisis, I went over in my mind what this action would mean with respect to the finances of the Government of the United States. It seemed to me that if we were to keep the economy on an even keel during the period ahead -- if we were to prevent the defense effort from producing strong inflationary pressures and otherwise unbalancing the economy -- our first line of defense on the financial front was a stable and confident situation in the market for United States Government securities. You can see from the previous discussion why I reached this conclusion.

Accordingly, on the day following the outbreak of hostilities in Korea -- that is, on Monday, June 26 -- I had the Fiscal Assistant Secretary of the Treasury convey to the Open Market Committee of the Federal Reserve System, my feeling that "everything possible should be done to maintain a basically strong position in the Government bond market during the present period of international disturbance". On July 17, I wrote at some length to Chairman McCabe of the Board of Governors of the Federal Reserve System, restating my feeling that stability in the Government bond market is of paramount importance because of the disturbed international situation and explaining my reasons in some detail. In this letter, I also stated that it was imperative that every financing operation of the Government be carried through to a successful conclusion. I have restated my conviction that stability in the Government security market is required on many occasions

since then -- both publicly and privately, and directly to Chairman McCabe and other officials of the Federal Reserve System.

As I have stated, officials of the Federal Reserve System have not agreed with me that the situation calls for stability in the Government bond market. The System has ignored, in its actions, the fact that the Secretary of the Treasury, as chief fiscal officer of the Nation, has grave responsibilities with respect to the management of the outstanding obligations of the Government of the United States. The System has made it clear that, in its opinion, it has complete right to disregard entirely the wishes of the Secretary of the Treasury and of the Government in managing the Government security market.

Although discussions of the differences between the viewpoints of the Treasury and the Federal Reserve on stability in the Government security market almost always start with the actions of August 18, the Federal Reserve -- right from the beginning of the outbreak of the conflict in Korea -- took actions to unsettle the Government security market. Despite my requests for a program which would promote confidence in the Government's financial position, the Open Market Committee did not stop its program of weakening the market for Government securities by continuously putting pressure on the long-term Government bond market. In the period from June 27 through August 18, the System sold \$1.1 billion of long bonds in 38 trading days.

My decision to maintain the 1-1/4 percent rate on the two issues of 13-month Treasury notes offered in exchange for the \$13-1/2 billion of Treasury bonds and certificates of indebtedness maturing on September 15 and October 1 was no surprise to the Federal Reserve. This offering -- which, in accordance with the laws of the United States, had the approval

of the President -- was in line with my policy of maintaining stability in the Government security market. The terms of the issues announced on August 18 were identical with the terms of the issues offered in connection with refunding the certificates of indebtedness which had matured on June 1 and on July 1. Furthermore, the terms of the new issues were in line with the market on the day of the refunding announcement, and met the needs of the market which required a short-term security at that time. Nevertheless, the Federal Reserve, at the opening of trading on Monday, August 21, immediately proceeded to run up the rates on short-term securities -- that is, mark down the prices of these issues -- to levels wholly inconsistent with the rate on the refunding offering of the Treasury.

There has been a great deal of emphasis on the fact that the Federal Reserve had to purchase a large portion of the maturing issues in the September-October refunding operation in order to prevent the Treasury from having to pay off almost the entire maturities in cash. What has never been made clear is that this so-called "support" would not have been required if the Federal Reserve had not changed the market on the first trading day after the financing announcement. The refunding issues were priced in line with the market, as I have said; and the market would have responded to the refunding operation satisfactorily, if the Federal Reserve had not immediately changed the market pattern of yields on outstanding securities. The Open Market Committee accomplished this by lowering the prices at which it sold Government securities from its portfolio, thereby giving purchasers a higher rate of return than they would receive on the new issues offered by the Government.

Obviously, most of the holders of the refunded issues did not choose to exchange them for the new issues. A great many of them did their own refunding

through the process of selling the maturing issues to the Federal Reserve System and buying back outstanding issues which were more favorably priced. Most of the remaining holders either sold their securities to the Federal Reserve and retained the cash, or turned in the maturing issues to the Treasury for cash. Only 5.8 percent of the refunded issues were exchanged for the new issues by private holders. The Federal Reserve exchanged 76.7 percent of the maturing issues; and the remainder, 17.5 percent, was turned in to the Treasury for cash. The cash pay-off of 17.5 percent compares with an average of about 5 percent paid off in cash in refunding operations of a similar nature during recent years. It is obvious, when one looks at the redemption experience, that the actions of the Federal Reserve in raising interest rates on Government securities made the refunding operation a failure. Moreover -- and perhaps of greater significance in its probable impact on confidence in the credit of the United States Government -- is the fact that, for the first time since 1931, a new Government security was traded in the market below par immediately upon issuance.

I have noted that the September-October refunding was approved by the President before its announcement. When it became apparent that the actions of the Federal Reserve System were threatening to cause a failure in the refunding operation, President Truman -- personally and by letter -- requested Chairman McCabe to see that the actions of the Federal Reserve System were consistent with maintaining confidence in the credit of the United States and stability in the Government security market. The President was assured that this would be done. In the weeks that followed, nevertheless, the Federal Reserve continued to push up rates on Government securities.

While these events were taking place, it was necessary for the Treasury to undertake another refunding offering. The terms of the refunding of \$8 billion of certificates of indebtedness and bonds maturing in December 1950 and January 1951 were announced on November 22. Because of the actions of the Federal Reserve in the intervening period, a higher interest rate had to be offered than in August in order to price the new issue in line with the market. Holders of the December-January maturing issues were, accordingly, offered 5-year Treasury notes drawing interest at the rate of $1\frac{3}{4}$ percent per year. The new issue was in accord with the Federal Reserve recommendation; and Mr. McCabe assured me of the full cooperation of the System in the refunding operation.

The announcement was made on November 22. The following day was Thanksgiving; so that Friday, November 24, was the first trading day after the announcement was made. On that day, the Federal Reserve permitted the market to go off sharply; and further unsettled market psychology by dropping the price on the Victory Loan $2\frac{1}{2}$'s by $\frac{2}{32}$ during the day. This latter action was of particular significance because this issue is the bellwether of the long-term bond market.

As a result of the continued uncertainty with respect to the price and yield outlook created in the minds of Government security owners, the cash redemption experience in the December-January refunding operation was only slightly better than in September-October. Cash redemptions amounted to $14\frac{1}{2}$ percent of the total of the maturing issues. As I have already noted, the average on offerings of this type has been a little over 5 percent in recent years.

In addition to unsettling the Government security market by sharp mark-downs in the prices of outstanding Government issues, the Federal Reserve System continuously instigated rumors of further increases of rates on Government securities and of impending upward changes in member bank reserve requirements. All of this led to further doubt and confusion as to where the Federal Reserve System intended to take the Government market.

This "planned confusion," as it was called by one market commentator, was supposed to make banks hold on to their Government securities and refrain from expanding loans. What actually happened was entirely different. There was so much confusion and unsettlement in the market that investors were restrained by fear from holding on to Government securities. As a result, the Federal Reserve portfolio of Government securities increased by nearly \$2-1/2 billion between June 30 and December 31 -- the opposite of the effect the Federal Reserve actions were intended to have.

Delete For a full understanding of the program which has been pursued by the Federal Reserve since last June, it is important to note the source of the Federal Reserve's power. The System has been given no mandate by law for initiating or directing the financial policies of the Government. The instruments which enable it to do so ^{by induction} have fallen into its hands accidentally.

First, the Federal Reserve System is virtually immune from public control. Second, it has tremendous capital resources -- a \$20 billion portfolio of Federal Government securities. Third, it has tremendous profits -- nearly all of them either received directly from the Government in the form of interest payments on holdings of Federal securities, or derived indirectly from the Government, as a result of operations in the Government security market.

The System can use its freedom from control and its great resources to go into the public financial markets and conduct operations -- for whatever purpose -- which result in setting the prices and yields on the entire marketable debt of the Federal Government.

When the Open Market Committee was given full statutory authority in 1935 to carry on all of the transactions for the Federal Reserve System in the public financial markets and to require the reserve banks to participate in these transactions, there was no possibility that such operations could influence to any appreciable extent the functioning of our financial system. The Federal debt at that time amounted to approximately \$33 billion, a figure which represented only about 13 percent of the total debt of the Nation. Government security holdings of the Federal Reserve System in 1935 amounted to about \$2 billion.

Between 1935 and the present time, the Federal debt has grown from \$33 billion to over \$250 billion. The Government security holdings of the Federal Reserve System, as I have noted, have grown from \$2 billion to over \$20 billion. Because the debt is widely distributed among institutional, business, and individual owners throughout the Nation, the Open Market Committee need use only a small part of its large holdings to establish any price level it chooses for the marketable securities of the Federal Government.

As I have already emphasized, powers of this magnitude, ^{unless carefully} ~~if exercised~~ *exercised with the greatest caution* without regard to the public interest, hold the possibility of irretrievably damaging the credit of the Government. They hold the possibility of driving nonbank investors out of the Government security market and forcing the Government to finance its needs by increasing resort to the banks -- the most inflationary type of financing which it would be possible to devise. *And it is precisely this risk which the Federal Reserve policy poses in a time of grave national emergency.*

STRICTLY CONFIDENTIAL

*Second draft
2/7/51
To the Secy.*

I am very happy to have this opportunity of appearing before the Banking and Currency Committee in order to discuss with you the problems involved in the management of the Nation's finances.

The responsibility for the sound conduct of the Nation's finances is a very grave one. Since the earliest days of our history, this responsibility has been placed with the Secretary of the Treasury. But the problems involved are not my problems alone. They are not the problems of the Congress alone. They are the problems of every citizen of this Nation.

Here is the situation as I see it. We have today a public debt amounting to over \$250 billion. Not long ago we were worrying about a debt which might reach \$50 billion. We did not know how the country would be able to stand such a debt. We did not know how it would affect the solvency of the Government. We did not know how it could be managed without disrupting the financial life of the Nation.

But our public debt today is more than five times that figure. It is the most important single factor in our financial structure. It represents one-half of all the debt obligations in the country. Mortgages, state and municipal securities, corporate bonds, other private obligations -- all of them added together only equal the sum total of the present debt of the Government.

Life insurance companies now own over \$13 billion of Federal Government securities -- about one-fifth of their total assets. Mutual savings banks own \$11 billion -- about one-half of their total assets. Nonfinancial corporations own \$20 billion, or nearly 15 percent of their current assets. Individuals own \$67 billion of Federal securities of all kinds -- representing approximately one-third of their total liquid assets of more than \$200 billion.

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Commercial banks hold more than \$61 billion -- representing approximately one-half of their earning assets.

Before World War II, the situation was entirely different. Financial institutions and business concerns had much more of their invested funds in private obligations. Only a very small proportion of our individual citizens were owners of the securities of their Government.

After World War II, the public debt was in a predominant position in the financial life of the Nation. The size, the importance, and the wide distribution of the debt are new facts to all of us. They create new problems. They place tremendous new responsibilities on the Secretary of the Treasury who is charged by law with the sound management of the Nation's finances. And under present conditions of international crisis and rising inflationary pressures, both the problems and the responsibilities are enormously increased.

Throughout the postwar period, as I have emphasized, the public debt was the most important single factor in the financial life of the Nation. But it has not been a disruptive factor. The problems involved in managing a public debt of over \$250 billion are unprecedented. But they have been successfully solved. During the postwar period the debt has been managed in such a way as to ease the problems of reconversion and promote our return to peacetime activity at the highest level of production and employment in history.

How was this accomplished? It was accomplished by means of maintaining stability in the market for Federal Government securities and by spreading the debt as widely as possible among the people of the Nation -- at the same time that bank holdings of Federal securities were being reduced.

The Treasury has been eminently successful in achieving these objectives. There has been no more dynamic period in our entire industrial history than

the past five years. There has been no similar period in which such a large volume of long-range programs for increasing productive capacity and for modernizing existing plant and operations were put into effect. Stability in the financial markets was essential to these programs. But the maintenance of stability did not require absolute inflexibility in interest rates. As the economy itself began to function smoothly at a new high level of activity and trade, more flexibility in the Treasury debt management program was achieved by allowing short-term interest rates to increase gradually. With the outbreak of the crisis in Korea, however, the considerations calling for a high degree of stability in the Government security market once more became all important.

Likewise, the Treasury achieved great success in its program for increasing the proportion of Federal securities in the hands of nonbank investors and reducing bank holdings of Government obligations. In the last half of 1950, the holdings of nonbank owners reached a new postwar peak, while bank holdings, correspondingly, fell to a new low for the postwar period. This shift in ownership is of the greatest significance at the present time, since it acts directly on the money supply by reducing the inflationary potential of bank assets.

These results could not have been achieved if our people had not had full confidence in the ability of the Government to manage the debt without disturbance to the economy. They could not have been achieved if the citizens of the Nation had not had full confidence in Government securities -- and acted on that belief.

Today, with the enormously increased financial requirements of the defense program before us, it is more important than ever before that people hold on

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to the Government securities which they now own. It is more important than ever before that they add to these holdings as their funds permit them to do so.

One of the obvious things that has to be done if we want people to hold on to an investment already made is to stabilize the price. During the present emergency, we must eliminate the fear that the owner or prospective buyer of an obligation of the Government is going to be penalized immediately by having the market price of his investment drop. Nobody who has any choice wants to hold on to a commodity that is going down -- that is being priced lower all the time. It doesn't take a financial expert to figure out the direct and immediate consequences of such a price decline on the personal finances of the security owner.

Let us make no mistake about it -- forcing up the interest rates on Federal Government securities means forcing down the price. It means slicing off a part of the investment which every owner of a marketable security has made in the obligations of the Government. It means that owners of demand obligations, such as savings bonds, may decide it is prudent to cash in their bonds -- to get their money out. There is little inducement to hold a fixed income obligation, like savings bonds, when the owners of other Government securities are getting increasingly higher returns.

Let me repeat again -- nobody wants a commodity that is going down in price. It is imperative that we keep the securities of the Federal Government attractive to owners and purchasers. It is imperative, therefore, that we keep the prices of these securities stable. We must avoid

every action which holds the risk of starting a rumor, a belief, or a fear that investment in Federal securities is not a good investment -- now or in the future.

These considerations are urgent at all times. With a Federal debt of over \$250 billion, interwoven throughout the financial fabric of the Nation, there is no period when we can afford to raise doubts as to the wisdom or prudence of an investment in Federal Government securities. Under present circumstances, however, when the money must be forthcoming for a greatly enlarged defense program, the considerations calling for a stable and confident situation throughout the whole broad structure of the public debt are magnified many times.

Because of the uncertainties of the international situation, we cannot foresee the full extent of the financial demands which may be made upon the Government. We know only that they will be very large. The Congress has already acted to increase the revenues of the Government. Further measures for a greatly enlarged revenue program are now being deliberated. I am faced with the fact, however, that our military spending is already rising at a rate which will result in a budget deficit of several billion dollars by the last quarter of this fiscal year. To the extent that additional revenue is not at hand to cover all of the Government's needs, we shall have to borrow. We shall have to increase our already large public debt.

Under any circumstances which we can foresee, there appears to be no possibility for some time to come of reducing the outstanding debt of the Government. This means that maturing obligations which come due must be refunded. Every holder of a maturing issue -- like every holder of a demand obligation, such as savings bonds -- may, of course, obtain cash for his

securities if he so desires. But the money to pay him will, in turn, have to be borrowed from someone else. During the remainder of this calendar year, for example, over \$50 billion of marketable securities alone must be refunded. This in itself is a tremendous financing operation. It cannot be conducted successfully without full confidence of the holders of the maturing obligations and of investors generally in the desirability and the wisdom of continuing their investment in securities of the Government.

These are the considerations which I must weigh if I am to fulfill my responsibilities for the sound conduct of the Nation's finances. In my view, they cannot be overemphasized. Questions and doubts as to the wisdom of investing in securities of the Government would lead to conditions of financial chaos. If these questions and doubts persisted to the point where important numbers of Federal security owners attempted to liquidate their holdings, irreparable harm would be done to the entire financial structure of the Nation.

Faced with these facts, and fully recognizing the public trust which is placed in me as Secretary of the Treasury, I cannot stand back while experiments affecting the public credit are being tried. Such experiments hold the risk of endangering the financial functioning of our Government and disrupting the financial life of the country at the very time when we must move swiftly, confidently, and surely in building up the defenses of our Nation.

The Federal Reserve has been pursuing a course of action during this period of international crisis which involves precisely this risk. The Federal Reserve has carried on a policy which has resulted in lowering substantially the prices of outstanding issues of Government securities. The

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stated purpose of this program is to check credit expansion by raising interest rates.

First and foremost, this program -- as I have just said -- is dangerous because it takes the grave risk of upsetting the debt structure of the country; not only the debt structure of the Government itself, but the private debt structure as well. This would involve all of the difficulties which I have discussed.

I ask why we should take such a risk; why we should even consider actions which might impair the credit of the Government of the United States. Even if the expansion of bank credit could be completely stopped by this method, it still does not seem rational or reasonable to use this weapon, knowing, as we do, the risk which it involves. Why -- at a time when it is possible to maintain the Government bond market at a level permitting new issues to be offered at no change in interest rates -- should we use a weapon which lowers the price of the outstanding securities of the Government, seriously unsettles the Government bond market, and raises doubts which, if not quisted, could impair the Government credit?

In the second place, even if bank credit expansion were completely restricted, the battle against inflation would not necessarily have been won in whole or in part. The present inflation is not fed only by bank credit expansion. During the years since the end of World War II, there have, at times, been advances in prices when there has been no expansion in bank credit and currency holdings -- bank credit and currency constitute the money supply of the country. There have been other periods when the price level stood still or declined, although the money supply was expanding.

Why then should we use changes in the interest rate at all to combat inflation?

The stock answer to this question is that, in times of inflationary pressures, we must use all of the weapons at our disposal. It does not seem to me that this theory is appropriate. It cannot be called anything but irresponsible to use measures which have the distinct possibility of doing more harm than they do good.

The discussion up to this point centers around why I would be opposed to the Federal Reserve anti-inflation program, even if it could be demonstrated that this program would check credit expansion. But I am also opposed to the Federal Reserve policy because it has not been proved that it is an effective measure in restraining bank loan expansion and in fighting inflation. The evidence, on the contrary, is all on the other side.

The record of recent months clearly shows that the Federal Reserve actions in increasing interest rates have had no perceptible effect on credit expansion. Total loans of all commercial banks expanded nearly \$8 billion in the last six months of 1950 -- an increase of a magnitude which has never been equalled in this country. We have had other extreme examples of attempts to control bank credit expansion by interest rate increases in the past history of our country. In the 1919-1920 inflationary period, rates on short-term Treasury issues were run up sharply until they reached nearly 6 percent; and the rate on call-money went as high as 30 percent. In 1929, rates on short-term Treasury issues were run up to above 5 percent; and the call-money rate went to 20 percent. Yet, bank credit expansion was not effectively checked until we had the market crashes with which all of us are familiar.

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The demonstrable results of the Federal Reserve actions in raising interest rates are those which affect the stability of the Government security market and confidence in the credit of the United States. The Government security market has been seriously unsettled; and the resulting fear has restrained investors from purchasing or holding on to Government obligations. The actions of the Federal Reserve System also have brought about two failures in Treasury refunding operations. Finally, the confusion and fear with respect to the prices and yields of Government securities may even have weakened the appeal of savings bonds. During the last part of 1950, there was a noticeable decrease in the sales of the larger denomination savings bonds and an increase in redemptions of these denominations, which are ordinarily bought by the more "sophisticated" investors.

These are the controlling factors in my opposition to increases in interest rates on Government securities.

There is, however, another sure effect of the Federal Reserve actions in raising interest rates which I cannot ignore. I refer to the increase in Government expenditures which will be required to pay for the higher interest rates which we are now forced to pay upon new issues of Government securities. The Treasury is often quoted as being only concerned with this one aspect of increased interest rates. I am sure that I have made it quite clear to you today that this is not the case. Nevertheless, it is the Treasury's responsibility to recommend fiscal policy which will use the taxpayers' money wisely. There is never any defense for needless increases in taxes. I am sure that you agree with me that to use the taxpayers' money to pay for further increases in the interest cost of the public debt in an ineffectual attempt to control inflation is absolutely unjustifiable.

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I believe it would be helpful to you in understanding the effects of the Federal Reserve's actions in raising interest rates on Government securities, if I spent a few minutes now discussing more specifically what has happened in the Government security market since the invasion of the Republic of Korea.

As soon as I received the news of the Korean crisis, I went over in my mind what this action would mean with respect to the finances of the Government of the United States. It seemed to me that if we were to keep the economy on an even keel during the period ahead -- if we were to prevent the defense effort from producing strong inflationary pressures and otherwise unbalancing the economy -- our first line of defense on the financial front was a stable and confident situation in the market for United States Government securities. You can see from the previous discussion why I reached this conclusion.

Accordingly, on the day following the outbreak of hostilities in Korea -- that is, on Monday, June 26 -- I had the Fiscal Assistant Secretary of the Treasury convey to the Open Market Committee of the Federal Reserve System, my feeling that "everything possible should be done to maintain a basically strong position in the Government bond market during the present period of international disturbance."

On July 17, I wrote at some length to Chairman McCabe of the Board of Governors of the Federal Reserve System, restating my feeling that stability in the Government bond market is of paramount importance because of the disturbed international situation and explaining my reasons in some detail. In this letter, I also stated that it was imperative that every financing operation of the Government be carried through to a successful conclusion.

On many occasions since then -- both publicly and privately, and directly to Chairman McCabe and other officials of the Federal Reserve System -- I have restated my conviction that stability in the Government security market is required.

As I have said, officials of the Federal Reserve System have not agreed with me that the situation calls for stability in the Government bond market. The System has ignored, in its actions, the fact that the Secretary of the Treasury, as chief fiscal officer of the Nation, has grave responsibilities with respect to the management of the outstanding obligations of the Government of the United States. The System has made it clear that, in its opinion, it has complete right to disregard entirely the wishes of the Secretary of the Treasury and of the President in managing the Government security market.

Although discussions of the differences between the viewpoints of the Treasury and the Federal Reserve on stability in the Government security market almost always start with the actions of August 18, the Federal Reserve -- right from the beginning of the outbreak of the conflict in Korea -- acted in a manner which unsettled the Government security market. Despite my requests for a program which would promote confidence in the Government's financial position, the Open Market Committee did not stop its program of weakening the market for Government securities by continuously putting pressure on long-term bonds. In the period from June 27 through August 18, the System sold \$1.1 billion of long bonds in 38 trading days.

My decision to maintain the 1-1/4 percent rate on the two issues of 13-month Treasury notes offered in exchange for the \$13-1/2 billion of Treasury bonds and certificates of indebtedness maturing on September 15

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and October 1 was no surprise to the Federal Reserve. This offering -- which, in accordance with the laws of the United States, had the approval of the President -- was in line with my policy of maintaining stability in the Government security market.

The terms of the issues announced on August 18 were identical with the terms of the issues offered in connection with refunding the certificates of indebtedness which had matured on June 1 and on July 1. Furthermore, the terms of the new issues were in line with the market on the day of the refunding announcement; and met the needs of the market which required a short-term security at that time. Nevertheless, the Federal Reserve, at the opening of trading on Monday, August 21, immediately proceeded to run up the rates on short-term securities -- that is, mark down the prices of these issues -- to levels wholly inconsistent with the rate on the refunding offering of the Treasury.

There has been a great deal of emphasis on the fact that the Federal Reserve had to purchase a large portion of the maturing issues in the September-October refunding operation in order to prevent the Treasury from having to pay off almost the entire maturities in cash. What has never been made clear is that this so-called "support" would not have been required if the Federal Reserve had not changed the market on the first trading day after the financing announcement. The refunding issues were priced in line with the market, as I have said; and the market would have responded to the refunding operation satisfactorily, if the Federal Reserve had not immediately changed the market pattern of yields on outstanding securities. The Open Market Committee accomplished this by lowering the prices at which it sold Government securities from its portfolio, thereby giving purchasers a higher rate of return than they would receive on the new issues offered by the Government.

Obviously, most of the holders of the refunded issues did not choose to exchange them for the new issues. A great many of them did their own refunding through the process of selling the maturing issues to the Federal Reserve System and buying back outstanding issues which were more favorably priced. Most of the remaining holders either sold their securities to the Federal Reserve and retained the cash, or turned in the maturing issues to the Treasury for cash. Less than 6 percent of the refunded issues were exchanged for the new issues by private holders. It is obvious, when one looks at the exchange experience, that the actions of the Federal Reserve in raising interest rates on Government securities made the refunding operation a failure.

I have noted that the September-October refunding was approved by the President before its announcement. When it became apparent that the actions of the Federal Reserve System were threatening to cause a failure in the refunding operation, President Truman -- personally and by letter -- requested Chairman McCabe to see that the actions of the Federal Reserve System were consistent with maintaining confidence in the credit of the United States and stability in the Government security market. The President was assured that this would be done. In the weeks that followed, nevertheless, the Federal Reserve continued to push up rates on Government securities.

While these events were taking place, it was necessary for the Treasury to undertake another refunding offering. The terms of the refunding of \$8 billion of certificates of indebtedness and bonds maturing in December

1950 and January 1951 were announced on November 22. Because of the actions of the Federal Reserve in the intervening period, a higher interest rate had to be offered than in August in order to price the new issue in line with the market. Holders of the December-January maturing issues were, accordingly, offered 5-year Treasury notes drawing interest at the rate of $1\frac{3}{4}$ percent per year. The new issue was in accord with the Federal Reserve recommendation; and Mr. McCabe assured me of the full cooperation of the System in the refunding operation.

The announcement was made on November 22. The following day was Thanksgiving; so that Friday, November 24, was the first trading day after the announcement was made. On that day, the Federal Reserve permitted the market to go off sharply; and further unsettled market psychology by dropping the price on the Victory Loan $2\frac{1}{2}$'s by $\frac{2}{32}$ during the day. This latter action was of particular significance because this issue is the bellwether of the long-term bond market.

As a result of the continued uncertainty with respect to the price and yield outlook created in the minds of Government security owners, the exchange experience in the December-January refunding operation -- while considerably improved over September-October -- was still far from satisfactory. Only 51 percent of the maturing issues were turned in to the Treasury by private holders for the new issues. Moreover, the cash redemption experience was only slightly better than in September-October. Cash redemptions amounted to $14\frac{1}{2}$ percent of the total of the maturing issues; in the previous operation they had amounted to $17\frac{1}{2}$ percent. This compares with an average on offerings of this type of a little over 5 percent in recent years.

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In addition to unsettling the Government security market by sharp mark-downs in the prices of outstanding Government issues, the Federal Reserve System continuously instigated rumors of further increases of rates on Government securities. This type of thing led to further doubt and confusion as to where the Federal Reserve System intended to take the Government market.

This "planned confusion," as it was called by one market commentator, was supposed to make banks hold on to their Government securities and refrain from expanding loans. What actually happened was entirely different. There was so much confusion and unsettlement in the market that investors were restrained by fear from holding on to Government securities. As a result, the Federal Reserve portfolio of Government securities increased by nearly \$2-1/2 billion between June 30 and December 31 -- the opposite of the effect the Federal Reserve actions were intended to have.

Although there was some pressure on the long end of the Government market, the events which I have just described affected primarily the short- and medium-term issues of Government securities. However, early in January, Mr. McCabe and Mr. Sproul -- President of the Federal Reserve Bank of New York -- outlined to me a program which would involve a complete reorientation of debt management policy. They proposed a program of further increases in interest rates, particularly in the long-term area. They also wanted me to put higher interest rates on savings bonds. It seemed to me, under these circumstances, that the time had come to settle for the duration of the emergency the matter of the rate on long-term Government bonds. Accordingly, I met with the President and Chairman McCabe to discuss the entire defense financing program. At this time it was agreed that market stability was essential and that, therefore,

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the 2-1/2 percent rate on long-term Government bonds should be maintained and that refunding and new-money issues should be financed within the pattern of that rate. This was immediately prior to the speech which I made on January 18, before the New York Board of Trade, announcing this policy.

As you all know, officials of the Federal Reserve System have publicly attacked this policy, despite the fact that Chairman McCabe had agreed to it before its announcement. Particularly Mr. Sproul and Mr. Eccles have strongly criticized the announced program. Moreover, subsequent to the announcement, the Federal Reserve System continued to put pressure on the long-term bond market. On January 29, the Open Market Committee again reduced its buying price on Victory Loan 2-1/2's. It was at this juncture that President Truman asked the Open Market Committee to meet with him, so that he could impress upon the Committee the need for stability in the Government bond market and confidence in the credit of the United States; and request that they govern their actions accordingly. You all know the results of this meeting.

For a full understanding of the program which has been pursued by the Federal Reserve since last June, it is important to note the source of the Federal Reserve's power.

In an act passed during the first session of the first Congress of the United States, the Secretary of the Treasury was given full responsibility for the conduct of the Nation's finances. This responsibility has remained with him since that time. The instruments which enable the Federal Reserve System

to assume this responsibility itself and to dictate the financial policies of the Government have fallen into its hands accidentally. They are the direct result of the great changes in our economy and in our financial life brought about by the increase in the public debt -- with an accompanying increase in the Government security holdings of the Federal Reserve System.

In 1913, when the Federal Reserve System was established, it was given permission by law to carry on transactions in the financial markets. This permission was thought of as an incidental part of its discount functions -- namely, as an incidental part of credit operations carried on between the banks and their own members. There was no thought and no possibility at that time that market operations could influence to any appreciable extent the financial policies of the Government.

For many years, such market transactions as were carried on by the System were conducted by informal groups or committees. In the middle Thirties, however, when the last major revision of the Federal Reserve Act took place, an agency for carrying on market transactions was established by law and was given full statutory authority to conduct all of the open market operations of the System. This agency was designated the Open Market Committee of the Federal Reserve System. It was made up of the seven Governors of the System, together with five of the presidents of the Reserve Banks. At that time -- as in 1913 -- there was no recognition that conditions might develop which would give this Committee the powers it now has to dominate the financial markets and to dictate the financial policies of the Government.

Between 1935 and the present time, the Federal debt has grown from \$33 billion to over \$250 billion. The Government security holdings of the

Federal Reserve System have grown from about \$2-1/2 billion to over \$20 billion. Because the public debt is widely distributed among institutional, business, and individual owners throughout the Nation, the Open Market Committee need use only a small part of its current holdings to change the interest rates and establish any price level it chooses for the marketable securities of the Federal Government. Because of the size of the public debt, this action in turn has the effect of a depth charge. It sets up repercussions which are felt throughout the entire economy.

As I have already emphasized, powers of this magnitude, if exercised without regard to the public interest, hold the possibility of irretrievably damaging the credit of the Government. They hold the possibility of driving nonbank investors out of the Government security market and forcing the Government to finance its needs by increasing resort to the banks -- the most inflationary type of financing which it would be possible to devise. I am certain that the Congress and the Nation will not wish to delay longer in removing the possibility of such a dangerous development during this critical period in the Nation's history.

I hope that I have succeeded today in dispelling the thought that there is any mystery about the steps which we must take if we are to finance our defense needs without harm to the economy. The problem is clear. Our course is plain. Let us now do away with futile theory and conjecture. Let us get on with our great task of building up our defenses by utilizing in full measure the strength, the vitality, and the power for growth of the American economy and the American financial system.

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The problem of an independent agency of the United States Government is again being highlighted by the current discussions about the relative roles of the Federal Reserve System and the U.S. Treasury. A great deal of nonsense is being talked about. No agency is made independent in order to make it possible to alter or sabotage the policies of the government of which it is a part.

The Federal Reserve is not seeking independence in the sense of being apart from political responsibility, which was the original concept, but is seeking an active role in the management of the public debt, without any commensurate responsibility for the outcome.

Would the Chairman of the Board of Governors of the Federal Reserve System like to be a member of the President's Cabinet? Would the Federal Reserve like to go to Congress and request the taxes to balance the Federal Budget? Would the Federal Reserve like to assume responsibility for the Federal Budget?

It is quite clear to me that the independence Woodrow Wilson wished to see the System acquire was in no way related to these responsibilities. If the statutory powers of the Federal Reserve are inadequate to meet the current situation, then the Congress and the Treasury should be seriously concerned with the matter, but the approach of the Federal Reserve

in the first instance should be to obtain the support of the Secretary of the Treasury for the changes deemed desirable, rather than to attempt to change the policies of the Treasury by means of the authority which it now has on issues which are clearly matters of judgment and not matters that can be demonstrated in black and white.

FLEXIBLE LONG-TERM INTEREST RATES AND DEBT MANAGEMENT

Is there any possibility of a quick resolution of the present differences of opinion between the Treasury and the Federal Reserve System which would both enable the Federal Reserve System to utilize the open-market techniques they favor during the next few months and, at the same time, avoid the adverse fiscal consequences of such operations?

The objection of the Treasury to the Federal Reserve proposals as they stand is that whereas they are avowedly directed at a short-term bank loan expansion problem, they would result in a substantial increase in the public debt service charge for the indefinite future.

The objection of the Federal Reserve to the Treasury's adamant stand in favor of the peg on the long-term government rate is that it makes it impossible for the Reserve System to do anything, under its present authority, to check bank loan expansion other than through selective credit controls.

In my opinion, both the Federal Reserve and the Treasury are on sound ground. The conflict could, however, be resolved if a way were found to enable the Federal Reserve to permit interest rate flexibility via open-market operations but at the same time to offset the fiscal consequences of higher yields on certain categories of government securities.

There is one line of approach which would, in theory at least, reconcile the two positions:

The Treasury could, for its part, agree to let the Federal Reserve go ahead and introduce sufficient flexibility into the long-term government securities rate to achieve the restrictions on bank loan expansion that the System thinks practicable over the next six months. The Federal and the Treasury would jointly request Congress to authorize the Reserve System to require commercial banks to establish special reserves of up to 50 percent against demand deposit liabilities.

The special reserves would be held in the form of special Treasury reserve certificates bearing interest at $1\frac{1}{2}\%$ and would always be redeemable at par on demand. The banks would be authorized initially to exchange any of their existing holdings of government securities at par or market, whichever is higher, for the Treasury reserve certificates.

The commercial banks would, no doubt, object violently to my proposal for the introduction of special reserve requirements, especially of this magnitude. If, however, the Federal Reserve System were to let the yield on long-term governments rise to $2\frac{3}{4}\%$ or higher during the first couple of months of its flexible rate operations and the market reached the conclusion that the future long-term government rate would be nearer 3 than $2\frac{1}{2}\%$, the commercial banks might be much more favorably disposed to an exchange of a portion of their existing long-term government securities for Treasury Reserve certificates. Since the present long-term government holdings of the banking system have been acquired at prices above par, they might even prefer to hold guaranteed $1\frac{1}{2}\%$ Treasury reserve certificates redeemable on demand to a mixed portfolio of government securities purchased at various prices, with the earlier purchases quoted at market prices involving a contingent liability against capital and surplus. But in any event, the Treasury and Federal Reserve System, standing together, might be able to persuade the Congress and the public that a guaranteed $1\frac{1}{2}\%$ rate was a reasonable return to the banks on an absolutely riskless Government security.

If this type of special reserve requirement were adopted, the Treasury would be able to count on having upwards of 40 billion dollars of the public debt carried permanently by the banking system at $1\frac{1}{2}\%$. This would be an offset against the higher rate on long-terms brought about by the Federal Reserve operations and also represent a permanent change in the composition of the Federal debt.

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MEMORANDUM:

I had an opportunity to discuss the new Treasury financing individually with each member of the Bankers group and, as you already know, they are very disturbed and most unhappy. All of them are convinced that lumping together the \$2.6 billion of 1-1/2 percent, maturing December 15, and \$5.3 billion of 1-1/8 percent certificates, maturing January 1st, would be most ill-advised. They do not think the market will take \$8 billion of securities unless a rate of 1-7/8 percent or two percent is placed on it.

While they are probably overly pessimistic, particularly if the Treasury and the Federal Reserve can get together and present a united front, nevertheless, their view may not be far wrong.

I feel quite confident that a 1-3/4 percent, five-year note to replace the December 15 notes, would be well received, oversubscribed, and release pressure on the 1-1/2 percent rate. When it comes to the larger amount due in January, I think one-half of it might be put into 1-3/4 percent, five-year notes. But if the entire amount were lumped with the previous offer, I am at least apprehensive that the issue will be soggy and difficult for the market to digest. At least it might be wise to test it a little bit before going overboard. To have a failure after the fiasco of August would be very serious at this time and prudent management requires weighting judgment on the side of discretion with a minimum of risk. Of course, it must be remembered that a five-year note would add that amount to maturities in 1955 which are already out of proportion to a proper financial pattern.

All the big bankers in New York and Chicago think this is very serious, personally, I doubt it and would prefer to run that risk rather than pay the

price of one-eighth and one-quarter higher for a longer maturity. Once this decision is out of the way, barring unforeseen conditions, no new financing will be required before June of next year, and we will have an opportunity to judge the cash needs of the rearmament program and the attitude of Congress toward the defense financing.

The Federal Reserve holds roughly \$13 billion of short-term securities which should be adequate for any legitimate demands to replace short-term maturities. This is probably unorthodox thinking to the Treasury technicians, but it seems to me that the market is the important thing to watch at this time, and I have tried to divorce myself completely from the views of anyone and to think of this problem in a vacuum entirely on my own.

As a student of Marget's and after talking to Mr. McCabe and Mr. Szymczak and attempting to evaluate the personalities, I would be inclined to divide up the \$8 billion into four and four as the more conservative thing to do. But on the bolder side, if you want to accept some risk, I would be inclined to take a chance on lumping the entire \$8 billion into five-year notes and, with a little good luck and some judicious support by the Open Market Committee, I would think the chances are 75-25 of success.

This sums up my best judgment both of the maturity of the present market and the psychological factors required to balance its recent adversity.

Last night I went back through Treasury history and can recall only two other periods of any value historically. One would appear to be the 1826-28 financing which, in comparable terms, was a mop-up from the protracted period of the War of 1812 and it seems to me worthy of study before finally coming to a decision. I also think there is a parallel, though perhaps a bit more forced,

in Grover Cleveland's administration when ill-advised Treasury financing produced the gold panic that forced him out of office and then four years later made possible his return through the calculated risk that Mr. Morgan took in underwriting the Treasury's gold -- one sound comment which may be of use. Assuming we are in the midst of a money revolution, there is a real parallel between the period following the panic of 1907 and the establishment of the Federal Reserve System of 1914.

I am working on developing this parallel in my spare time but think you might bear it in mind in considering the problem of lengthening the debt and maintaining reasonably stable interest rates.

There are obviously many, and perhaps decisive, political difficulties in the way of getting legislative approval to any form of special reserves requirements at this session of Congress. The above suggestion might well be even more objectionable to Congress than the more orthodox type of special reserves requirements, namely, long or short-term government securities or cash reserves at the option of the commercial bank. But if the Treasury and the Federal Reserve jointly supported the proposal as the one permanent means (which I think it is) of reconciling flexible long-term interest rates on government securities and U.S. debt management requirements under circumstances prevailing in this country, the onus for its rejection would be placed squarely on Congress. If that happened, Congress would also have to accept the responsibility for the fiscal consequences of the higher yield on government securities resulting from the Federal Reserve open-market operations.

Whatever the drawbacks of the above approach may be, I have personally reached the conclusion that there are no alternative methods for controlling bank loan expansion in sight that would be acceptable to the Federal Reserve System and at the same time preserve rigidly the peg principle. Direct loan ceilings are open to a variety of administrative and political difficulties which are, in my judgement, probably insuperable. Special reserve requirements, taken by themselves, would not fully meet the bank loan expansion problem and in any event would require time for legislative approval. The alternatives on which agreement might be reached would, in my judgment, be some compromise with the Federal Reserve on the government peg principle which would hold to a minimum the adverse fiscal impact, or an agreement to try to get a fundamental solution along the above lines which would couple interest rate flexibility with a major new instrument of bank reserve control - debt management policy.

It was clearly understood by all that these were explorations at the technical level and not negotiations.

Lengthy discussion of the techniques of the Open Market Committee and the necessity for greater liason between the Federal Reserve and Treasury was a part of the early discussion, and it was clear that both of us could be better informed on the thinking of the other.

Inasmuch as the Federal Reserve group had a specific proposal, approved by the Open Market Committee, in the letter of February 7 of Chairman McCabe to the Secretary, most of the discussion attempted to clarify what was intended in that letter.

The Federal Reserve group continuously asserted the unhappiness of the Open Market Committee in continual monetization of the Federal Debt, particularly at premium prices.

There was considerable discussion of the rigidities in the present market and the fact that a large amount of selling was probably because of commitments already made by insurance companies, savings banks, loan associations and the banking system, and the consequent replenishing of reserves through sales to the Federal Reserve in the open market of Government securities.

Simultaneously pursuing this policy, they intended to withdraw support from the short term securities market which would be expected to adjust itself around the 1-3/4% discount rate now prevailing. They felt that when these adjustments were made, a groundwork would be laid in the market which would deter lending and make it possible to undertake in a more orderly fashion, although at somewhat higher rates, the re-financings which the Treasury faces in the next six months of the

Calendar Year 1951.

Much of their argument revolves around the traditional abhorrence of the banks for borrowing from the Federal Reserve and an aggregate reduction of needed reserves as the short term rate adjusts on the discount rate as a governor.

Under considerable pressing by the Treasury group, they were willing to undertake for a period of time running thru at the most March 1952, or at least through December 1951, a fixed pattern of rates covering new money and refinancing at the levels established as a result of these adjustments.

There was long discussion, and much of it sympathetic to a proposal advanced principally by Mr. Riefler that the Secretary announce a non-marketable 2-3/4% long term bond (29-1/2 years) which could be exchanged for the June or December 2-1/2's, the desire being to lock these two issues up as much as possible and remove them as an important market factor. A feature of this issue might be an alternative of exchange for 1-1/2% five-year notes for those who desired more liquidity. Nevertheless, the clear intent was to drop the long term issues to par and hence rule out for the time being at least the issuance of any 2-1/2% bonds of longer maturity than 17 years.

At the concluding session it was suggested by the Treasury group that if the Secretary should accede to the Federal Reserve proposal with respect to the adjustment of the short term rates and the announcement of a 2-3/4% long term issue, to be exchanged for the outstanding long term issues, would the Federal Reserve undertake to maintain the current levels in the June and December issues?

This was put forward, not as a counter proposal, but on an exploratory basis and with an earnest plea on the part of Mr. Bartelt that we not attempt to prejudge the market, and his hope that such an arrangement would release pressure from the market and permit us to get a start on the refinancing program without impairing any further public confidence in the markets.

It was suggested by the Federal that we might agree to buy two hundred million of the long terms - one hundred million by the Treasury, one hundred million by the Federal, and then agree to purchase another four hundred million - 75% or three hundred million to be purchased by the Treasury, and one hundred million or 25% to be purchased by the Federal, and when six hundred million had been purchased to re-examine the problem.

There was a lot of talk about secrecy and the difficulty if such an agreement leaked in any other way than through the published statements of the Federal and the Treasury, and the belief on Mr. Bartelt's part that knowledge that the Treasury and the Federal had gotten together would act as a tonic in restoring confidence to the market.

There was general agreement throughout the discussions that the so-called feud between the Treasury and Federal was by far the most significant psychological factor in the current situation.

After extended discussion, it seemed to be generally agreed by all that the Federal Reserve approach was essentially a "package one" and is not susceptible, with any consistency, to very much compromise, unless there is a drastic change in the existing market situation, which on the basis of our talks appeared unlikely in the near future. It is the Federal

view that their proposal would involve no serious disruption of the security market and they seem to be contending that the increased flexibility of the market would produce more confidence.

Their major point is an unwillingness on their part to continue monetization of debt although they concede that this monetization would continue, although in their judgment at a reduced pace and at less cost to them if the support prices were reduced.

Under continuous questioning, there was general agreement that we were discussing degrees rather than absolutes, and the Treasury was questioning the effectiveness of the operation, and also questioning the Federal evaluation that the repercussions in the market would not be serious.

It was clear that at least on a theoretical basis whatever consistency there was in what obviously were two essentially opposing concepts seemed along the line of either following the Federal proposal in its entirety or pursuing the course advocated by the Secretary in his January 18 address accepting the necessity of some further monetization of the debt during the emergency period, but attempting to minimize its effects through other means than a revision of interest rates.

At the end of the meetings it was made clear again that these were exploratory talks and that no counter proposals had been offered by the Treasury. Accordingly, it was suggested that the matter now be referred to a higher level where negotiations or counter proposals might take place.

The Treasury and Federal Reserve System have been actively pursuing the problems connected with the refinancing of some \$39 billion of short and medium-term debt during the balance of the calendar year of 1951.

In conformity with the address of the Secretary of the Treasury on January 18, 1951, every effort is being made to foresee the best possibilities of reorienting the market in such a manner as to facilitate the orderly spacing and stable relationships of a structure which will not facilitate the 2-1/2 percent long-term rate. It is proposed that the \$19-1/2 billion of June and Victory 2-1/2's be ^{unpledged} unpaid in such a way as to lock up as much of this issue as possible. A 2-3/4 percent non-marketable, non-redeemable issue would be exchangeable for these securities if the owners so desire or if they wished shorter term maturities, they may exchange their holdings for a 1-1/2 percent, five-year note issued at par to yield approximately the same coefficient. In the interim period, the short-term rate would be permitted gradually to rise until it approaches the discount rate and the banks would be expected to replenish their reserves by borrowing directly from Federal Reserve banks. Since the banks traditionally ^{allow borrowing} for reserve purposes, it is felt by the Federal officials that pressure will be exerted to restrain additional lending if reserves are inadequate.

At best, this is only a flee bite but, nevertheless, it does have some bite and may produce some results. At least the general market for Federal securities will be relaxed in such a way that water can seek its own level.

A PROPOSAL

With a view to reconciling the debt management problem of the Treasury with the problem of controlling credit by the Federal Reserve, the Secretary of the Treasury authorizes the fiscal and technical staffs of his department to negotiate with the Federal Reserve on the following basis:

3-7-72
The purpose of this negotiation is to reduce to a minimum the creation of bank reserves through monetization of the public debt without creating a market psychology which would entail a lack of confidence in the stability of the Government securities market. More specifically, the purpose of the proposal is to relieve the Federal Reserve to the fullest extent practicable of the support of long-term Governments without compelling the Treasury to refinance maturing obligations during this calendar year, or to finance new fund requirements, on the basis of indeterminable rising interest rates. This can be accomplished within the framework of the 2-1/2% long-term interest rate pattern announced by the Secretary of the Treasury in his address before the New York Board of Trade on January 18.

The proposal involves 3 elements, (1) a new nonmarketable security to be issued in exchange for outstanding long-term 2-1/2% bonds of June and December, 1967-72, (2) refunding the ~~\$40~~ billion of maturing securities between June 15 and December 15 of this year, and (3) the raising of new funds to finance the present emergency.

These elements, while interrelated, will be dealt with separately.

EXCHANGE OFFERING OF NONMARKETABLE 2-3/4% BOND FOR OUTSTANDING RESTRICTED TREASURY BONDS OF 1967-72.

In consideration of an agreement on the part of the Federal Reserve to maintain a stable securities market, as more specifically outlined

below, the Secretary of the Treasury would agree to issue a long-term 29-year 2-3/4% nonmarketable security, which would not be redeemable by the Treasury prior to maturity, but which would be exchangeable prior to maturity for 1-1/2% 5-year Treasury notes. The purpose of this offering would be (a) to retire a large segment of the marketable debt, which is now causing difficulties for the Federal Reserve, and (b) provide a degree of flexibility for holders of the new nonmarketable security by making them exchangeable for a 1-1/2% 5-year note that could be sold on the market in case cash funds are needed. At the same time it avoids an increase in the demand obligations of the Treasury.

One of the merits of the proposal is that it avoids a prejudging of the securities market. It is believed that this exchange privilege would give bouyancy to the restricted Treasury bonds of 1967-72, since the "rights" or exchange privilege would be attractive to long-term investors who are more interested in interest return than they are in speculative possibilities. Thus, there would be created a buyers' market for the restricted Treasury bonds of 1967-72, and to this extent should relieve the Federal Reserve of a great deal of pressure. Conceivably, if market confidence would be restored through an unequivocal joint announcement by the Treasury and Federal Reserve that an agreement had been reached, the present market support problem of the Federal Reserve might disappear.

It is realized, of course, that consideration would have to be given by the technical staffs of the Treasury and the Federal Reserve as to the effect of this action on other outstanding marketable securities in the intermediate and long-term area.

In order to provide for this proposal a fair and reasonable testing period, it would be necessary for the Federal Reserve to agree to support the securities affected at present market levels. In a spirit of cooperation the Federal Reserve and the Treasury should become partners in the support program under which each agency would take a pro rata share of any purchases that may be required; that is, the Federal Reserve Open Market Account would take a percentage of the purchases and the Treasury would take the balance for Government investment account. It has been suggested, for instance, that the first \$200 million purchased under the agreement would be shared equally by the Treasury and the Federal Reserve; that the Treasury and Federal Reserve would finance 75% and 25%, respectively, of the succeeding \$400 million; and that the Treasury would carry the full amount in excess of \$600 million. This would seem to be a reasonable basis of purchase during a testing period, but there is an inherent danger in the event of a "leak" that the Reserve is committed to a stated amount. While it is realized that the Federal Reserve might not be willing to accept an "open end" agreement, it must be recognized that public knowledge of a limitation would not encourage market confidence.

REFUNDING OF THE \$40 BILLION OF MATURING SECURITIES
BETWEEN JUNE 15 and DECEMBER 15 OF THIS YEAR

During the 6 months period, June 15 - December 15, the Treasury will be required to refund almost \$40 billions of maturing obligations, exclusive of Treasury bills. Success of this refunding demands confidence in the stability of the Government securities market. Therefore, it is imperative that the Treasury and the Federal Reserve reach an agreement on a monetary-debt policy for the balance of the calendar year, at least. Obviously, this program should not be encumbered with uncertainty, misunderstanding, and the prospect of rising interest rates. In return for an understanding that the Federal Reserve would maintain a stable price level during this period of financing so that the Treasury would not be required to finance on a rising interest rate, the Treasury ^{would} might agree to a policy under which the Federal Reserve would allow the short-term securities market to adjust itself before June 15 around the 1-3/4% discount rate now prevailing. From the Treasury point of view it would be desirable to extend this period of stability for the duration of the emergency, but it is doubtful whether the Federal Reserve would be willing to commit itself that far ahead. On the other hand, if a closer working relationship could be established between the technical staffs of the Federal Reserve and the Treasury, it may be possible to suggest a program of monetary-debt management which might be acceptable to the policy-making officials.

THE RAISING OF NEW FUNDS TO FINANCE THE PRESENT EMERGENCY

On the basis of the President's budget estimates, and without making allowance for an increase from new taxes, it is estimated that new borrowings from this time to June 30, 1952 will amount to approximately \$23 billion, distributed as follows: May 1951 \$3.6 billion; July \$6.5 billion; October \$7.5 billion; April 1952 \$5.4 billion. These figures make allowance for attrition on debt refunding operations of \$3.6 billion, in addition to the cash deficit. The figures might be reduced by a revitalized savings bonds program and a revision of the yields on Treasury savings notes.

Conferences with the Federal Reserve on the technical level might be helpful in laying out a program of debt composition in order that the Reserve may consider itself a full partner with the Treasury in maintaining a market for the securities after they have been issued.

It is generally recognized that there are no substantial amounts of non-bank funds seeking investment at the present time. Some people seem to think that there will be funds seeking investment sometime this Fall after other sources of investment have declined. It would seem that there would be no need at this time to attempt to prejudge the market so far ahead or to assume that the 2-1/2% long-term rate mentioned in the January 18 address will not be appropriate. Therefore, if a joint announcement of the Treasury and the Federal Reserve should be agreed upon, with a view to reestablishing market confidence, reference might be made to the fact that the Series G bond or the Investment Series Bond issued in 1947 might be made available for

purchase by non-bank investors from time to time, the purpose of this reference being to indicate that there has not been abandonment of the policy statement in the January 18 address.

While the following might appear unduly optimistic, and would, of course, depend a great deal upon the effectiveness of selective controls and other factors affecting the availability of investments, there is a possibility that this program may be of assistance to the Federal Reserve in de-monetizing some of the public debt which it now holds, and may enable the Treasury to acquire new money by selling in the market some of the restricted 2-1/2% bonds of 1967-72 previously acquired for Government investment account.

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MEMORANDUM FOR The Secretary of the Treasury and
The Chairman of the Board of Governors
of The Federal Reserve System

During the past few months I have discussed with each of you many times my concern over the problem of inflation and the approaches which might be taken by the Government to control it. The Government has during this period taken many steps to bring the problem of inflation under control.

Under existing practices

In my consideration of the inflation problem, I have been aware of the difficulties faced by the Federal Reserve System in controlling private credit expansion at a time when we have a large public debt. All of us recognize, of course, that credit expansion is simply one phase of the whole inflation problem; and that, in fact, some credit expansion is necessary to facilitate the growth of production which is essential to the defense effort. But, the expansion of loans, not only by the banking system but by financial institutions of all types, adds fuel to other inflationary forces and must be stopped to the greatest extent possible consistent with the needs of the defense effort. In stopping credit expansion, however, I feel that we should use measures that are fully consistent with the ~~necessity for~~ maintaining stability in the Government security market and confidence in the credit of the United States.

Loans are other

As you know, it is likely that we shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year because of the seasonal nature of tax receipts which concentrate collections in the first half of the year and the inevitable lag between the imposition of new taxes and their collection by the Treasury. It is my hope that such new money as it is necessary for the Treasury to borrow during the months ahead to

through increased savings by the public.

finance our military requirements can be obtained in the least inflationary manner possible, [that is, from true investors outside of the banking system.]

With these considerations in mind, I ask that each of you give thought to the type of program that might be worked out along the following lines -- a program which would provide the necessary restraint on credit expansion and at the same time make it possible to maintain stability in the market for Government securities. This program would (1) control bank loans through the utilization of the powers provided by the Emergency Banking Act of 1933 and, possibly, the Trading with the Enemy Act; (2) set up a committee similar to the Capital Issues Committee of World War I; and (3) further restrain the lending and mortgage insurance activities of the various Government credit agencies.

(1) The powers provided in the Emergency Banking Act of 1933 could be utilized to curtail lending by member banks of the Federal Reserve System. These powers are vested in the Secretary of the Treasury. The program could be administered by the 12 Federal Reserve Banks, each in its own Federal Reserve District. It is contemplated that the credit needs of the country are likely to be such that the program might well permit flexibility between Federal Reserve Districts and individual parts of such Districts, in order to allow for the financing of certain types of industrial and commercial, as well as State and local, projects necessary to the defense effort. The program could be extended to institutions other than member banks if desired through application of powers provided by the Trading with the Enemy Act.

(2) A committee similar to the Capital Issues Committee of World War I, but operating in a broader area, could be created by

Executive Order. The objectives of this Committee would be to prevail upon borrowers to reduce their spending and to curtail their borrowing, and to prevail upon lenders to limit their lending. This committee would work closely with the defense agencies under Mr. Wilson with the objective of curtailing allocations of critical and essential materials where necessary to ~~compel~~ cooperation.

reduce

- (3) The activities of Government credit agencies might be curtailed further, and I am willing to consider the issuance of appropriate orders along this line to such agencies, among others, as the Federal Housing Administration, the Veterans Administration, the Farm Credit Administration, and the Reconstruction Finance Corporation. Indeed, it is possible we should give thought to a virtual moratorium on the activities of these agencies, except to the extent that their activities contribute directly to the defense effort.

Preemption of these activities of these agencies which facilitate new borrowing

It is my belief that the addition of the foregoing to the present selective credit controls will provide a well-balanced program of credit curtailment. It will do the very thing that each of us has been so concerned about in recent months -- that is, effectively restrain the expansion of loans. Pending the development of this program, I hope that no further attempt will be made to change the interest rate pattern, and that unquestioned stability in the Government security market, which is imperative at this critical time for the financing of the defense effort, will be maintained.

such

Such a program would aim directly at the restriction of non-defense private borrowing, and would not increase the cost of essential borrowing. It would be analogous to our restrictions upon the non-defense use of materials.

stabilization

MEMORANDUM FOR The Secretary of the Treasury and
The Chairman of the Board of Governors
of The Federal Reserve System

During the past few months I have discussed with each of you many times my concern over the problem of inflation and the approaches which might be taken by the Government to control it. The Government has during this period taken many steps to bring the problem of inflation under control.

In my consideration of the inflation problem, I have been aware of the difficulties faced by the Federal Reserve System under existing practices in controlling private credit expansion at a time when we have a large public debt. All of us recognize, of course, that credit expansion is simply one phase of the whole inflation problem; and that, in fact, some loans are necessary to facilitate the growth of production which is essential to the defense effort. But, the expansion of other loans, not only by the banking system but by financial institutions of all types, adds fuel to other inflationary forces and must be stopped to the greatest extent possible consistent with the needs of the defense effort. In stopping credit expansion, however, I feel that we should use measures that are fully consistent with maintaining stability in the Government security market and confidence in the credit of the United States.

As you know, it is likely that we shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year because of the seasonal nature of tax receipts which concentrate collections in the first half of the year and the inevitable lag between the imposition of new taxes and their collection by the Treasury. It is my hope that such new money as it is necessary for the Treasury to borrow during the months ahead to finance our military requirements can be obtained in the least inflationary manner possible through increased savings by the public.

With these considerations in mind, I ask that each of you give thought to the type of program that might be worked out along the following lines -- a program which would provide the necessary restraint on credit expansion and at the same time make it possible to maintain stability in the market for Government securities. This program would (1) control bank loans through the utilization of the powers provided by the Emergency Banking Act of 1933 and, possibly, the Trading with the Enemy Act; (2) set up a committee similar to the Capital Issues Committee of World War I; and (3) further restrain the lending and mortgage insurance activities of the various Government credit agencies.

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administered by the 12 Federal Reserve Banks, each in its own Federal Reserve District. It is contemplated that the credit needs of the country are likely to be such that the program might well permit flexibility between Federal Reserve Districts and individual parts of such Districts, in order to allow for the financing of certain types of industrial and commercial, as well as State and local, projects necessary to the defense effort. The program could be extended to institutions other than member banks if desired through application of powers provided by the Trading with the Enemy Act.

- (2) A Committee similar to the Capital Issues Committee of World War I, but operating in a broader area, could be created by Executive Order. The objectives of this Committee would be to prevail upon borrowers to reduce their spending and to curtail their borrowing, and to prevail upon lenders to limit their lending. This committee would work closely with the defense agencies under Mr. Wilson with the objective of curtailing allocations of critical and essential materials where necessary to induce cooperation.
- (3) The activities of Government credit agencies might be curtailed further, and I am willing to consider the issuance of appropriate orders along this line to such agencies, among others, as the Federal Housing Administration, the Veterans Administration, the Farm Credit Administration, and the Reconstruction Finance Corporation. Indeed, it is possible we should give thought to a suspension of those activities of these agencies which facilitate new borrowing, except to the extent that such activities contribute directly to the defense effort.

It is my belief that the addition of the foregoing to the present selective credit controls will provide a well-balanced program of credit stabilization. It will do the very thing that each of us has been so concerned about in recent months -- that is, effectively restrain the expansion of loans. Such a program would aim directly at the restriction of non-defense private borrowing, and would not increase the cost of essential borrowing. It would be analogous to our restrictions upon the non-defense use of materials. Pending the development of this program, I hope that no further attempt will be made to change the interest rate pattern, and that unquestioned stability in the Government security market, which is imperative at this critical time for the financing of the defense effort, will be maintained.

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As you know, it is likely that we shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year because of the seasonal nature of tax receipts which concentrate collections in the first half of the year and the inevitable lag between the imposition of new taxes and their collection by the Treasury. It is my hope that such new money as it is necessary for the Treasury to borrow during the months ahead to finance our military requirements can be obtained in the least inflationary manner possible through increased savings by the public.

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DRAFT 2/25/51

Memorandum for: The Secretary of the Treasury,

The Chairman of the Board of Governors of the
Federal Reserve System,

The Director of Defense Mobilization,

The Chairman of Council of Economic Advisors.

I have been much concerned with the problem of reconciling, on the one hand, the maintenance of stability in the Government security market and ^{full} confidence in the public credit of the United States with, on the other hand, the necessary restraint on private credit expansion at this time. This is one important facet of the complex problem of controlling inflation during a defense emergency which requires the full use of our economic resources.

It would be relatively simple to restrain private credit if that were our only objective, or to maintain stability in the Government security market if that were our only objective. But in the current situation, both objectives must be achieved within the framework of a complete and consistent economic program.

We must maintain a stable market for the very large financing operations of the Government. At the same time, we must

maintain flexible methods of dealing with private credit in order to fight inflation. We must impose restraints upon non-essential private lending and investment. At the same time, we must maintain the lending and credit facilities which are necessary to expand the industrial base for a constant build-up of our total economic strength. Instead of fighting inflation by the traditional method of directing controls toward reducing the overall level of employment and productive activity, a defense emergency imposes the harder task of fighting inflation while striving to expand both employment and production above what would be regarded as maximum levels in normal peacetime.

What we do about private credit expansion and about the Government securities market is, of course, only a part of the problem that confronts us. A successful program for achieving production growth and economic stability in these critical times must be a total program.

This requires a unified, consistent, and comprehensive attack upon our economic problems along the whole front. It must include, in proper proportion, production expansion policy, manpower policy, tax policy, credit policy, debt management and

monetary policy, and a wide range of direct and indirect controls over materials, prices and wages. All of these policies are necessary; each of them must be used in harmony with the rest; none must be used in ways that nullify others. The Government must necessarily take the lead in developing a unified program which weighs and combines all of the policies which are needed.

We have been striving in this emergency to develop such a unified program in the public interest. Much progress has already been made, both on the production front and on the anti-inflation front. Many peacetime activities of Government, including the activities of lending and financing agencies, have been pruned down. Cutbacks of civilian supplies and allocations of essential materials have been successfully undertaken. Important expansion programs for basic materials and productive capacity needed in the defense effort have been gotten underway. Price and wage controls have been initiated. Restraints on consumer and real estate credit have been applied. Large tax increases have been enacted, and additional tax proposals are now pending. In all these fields further action is being planned and will be taken as needed.

One outstanding problem which has thus far not been solved to our complete satisfaction is that of reconciling the policies concerning public debt management and private credit control. Considering the difficulty of this problem, we should not be discouraged because an ideal solution has not yet been found. The essence of this problem is to reconcile two important objectives, neither of which can be sacrificed.

On the one hand, we must maintain stability in the Government security market and confidence in the public credit of the United States. This is important at all times. It is imperative now. We shall have to refinance the billions of dollars of Government securities which will come due later this year. We shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year, even assuming the early enactment of large additional taxes, because of the seasonal nature of tax receipts which concentrate collections in the first half of the year, and because of the inevitable lag between the imposition of new taxes and their collection by the Treasury. Such huge financial operations can be carried out

successfully only if there is full confidence in the public credit of the United States based upon a stable securities market. Until a new program, referred to below, can be developed consistently with this objective, I hope that no attempt will be made to change the interest rate pattern, so that unquestioned stability in the government security market may be maintained.

On the other hand, we must curb the expansion of private loans, not only by the banking system but also by financial institutions of all types, which would add to inflationary pressures. This type of inflationary pressure must be stopped, to the greatest extent consistent with the defense effort and the achievement of its production goals.

The maintenance of stability in the Government securities market necessarily limits substantially the extent to which changes in the interest rate can be used in an attempt to curb private credit expansion. Because of this fact, much of the discussion of this problem has centered around the question of which is to be sacrificed -- stability in the Government securities market or control of private credit expansion. I am firmly convinced that this

is an erroneous statement of the problem. We need not sacrifice either.

Changing the interest rate is only one of several methods to be considered for curbing credit expansion. Through careful consideration of a much wider range of methods, I believe we can achieve a sound reconciliation in the national interest between maintaining stability and confidence in public credit operations and restraining expansion of inflationary private credit.

We have effective agencies for considering this problem and arriving at a proper solution.

Over the years, a number of important steps have been taken towards developing effective machinery for consistent and comprehensive national economic policies. One of the earliest steps in this century was the establishment of the Federal Reserve System before World War I. At that time, under far simpler conditions than those now confronting us, the Federal Reserve System was regarded as the main and central organ for economic stabilization. After World War II, in a much more complex economic and a much more complex framework of governmental activities affecting the economy, the

Council of Economic Advisers was established by the Congress under the Employment Act of 1946 to advise the President and help prepare reports to the Congress concerning how all major economic policies might be combined to promote our economic strength and health. Still more recently, in the current defense emergency, the Office of Defense Mobilization has been established to coordinate and direct operations in the mobilization effort. In addition, some of the established departments, such as the Treasury Department, have always performed economic functions which go beyond specialized problems and affect the whole economy.

Consequently, I am requesting the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers to study ways and means to provide the necessary restraint on private credit expansion and at the same time to make it possible to maintain stability in the market for Government securities. Among other things, I ask that you consider specifically the desirability of measures: (1) to limit private lending through voluntary actions by private groups, through Government-sponsored voluntary actions such as was done in a narrow field by the Capital Issues Committee of

World War I, or through direct Government controls; (2) to provide the Federal Reserve System with powers to impose additional reserve requirements on banks.

Under the first heading, I am sure that you are aware of the efforts that are already underway by the American Bankers Association, the Investment Bankers Association, and the life insurance association. I want you to consider the desirability of this or other kinds of private voluntary action in bringing about restraint on the part of lenders and borrowers.

I should like you to consider also the establishment of a committee similar to the Capital Issues Committee of World War I, but operating in a broader area. The objectives of such a Committee would be to prevail upon borrowers to reduce their spending and to curtail their borrowing, and to prevail upon lenders to limit their lending. The activities of this committee could be correlated with those of the defense agencies under Mr. Wilson with the objective of curtailing unnecessary uses of essential materials.

Furthermore, I should like you to consider the necessity and feasibility of using the powers provided in the Emergency Banking Act of 1933 to curtail lending by member banks of the Federal Reserve

System. These powers are vested in the Secretary of the Treasury subject to my approval. The Secretary could by regulation delegate the administration of this program to the 12 Federal Reserve Banks, each to act in its own Federal Reserve District under some flexible procedure. The program could be extended to institutions other than member banks, if desired, by using the powers provided by the Trading with the Enemy Act.

Under the second heading, you will recall the recommendation I made to the Congress a number of times in recent years to provide additional authority for the Federal Reserve System to establish bank reserve requirements. I should like you to consider the desirability of making that or another recommendation with the same general purpose at the present time.

You are all aware of the importance of this problem, and the need for an early resolution. I should like your study to proceed as rapidly as possible. I hope you will be able to give me at least initial recommendations by March 15. I am asking the Secretary of the Treasury to arrange for calling this group together at mutually convenient times.

As we effectively solve this problem of maintaining the stability of the Government securities market and restraining private credit expansion, we shall, of course, continue vigorously the constant review of Government lending and loan guarantee operations. Since the middle of last year, we have taken a series of steps to curtail such operations and limit them to amounts needed in this defense period. These operations are under constant review, as part of our overall anti-inflationary program, and action in this field will be kept in step with action in other related fields.

Memorandum for: The Secretary of the Treasury,

The Chairman of the Board of Governors of the
Federal Reserve System,

The Director of Defense Mobilization,

The Chairman of Council of Economic Advisers.

I have been much concerned with the problem of reconciling two objectives: first, the need to maintain stability in the Government security market and ~~full~~ confidence in the public credit of the United States, and second, the need to restrain private credit expansion at this time. How to reconcile these two objectives is an important facet of the complex problem of controlling inflation during a defense emergency which requires the full use of our economic resources.

It would be relatively simple to restrain private credit if that were our only objective, or to maintain stability in the Government security market if that were our only objective. But in the current situation, both objectives must be achieved within the framework of a complete and consistent economic program.

We must maintain a stable market for the very large financing operations of the Government. At the same time, we must

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maintain flexible methods of dealing with private credit in order to fight inflation. We must impose restraints upon non-essential private lending and investment. At the same time, we must maintain the lending and credit facilities which are necessary to expand the industrial base for a constant build-up of our total economic strength. Instead of fighting inflation by the traditional method of directing controls toward reducing the overall level of employment and productive activity, a defense emergency imposes the harder task of fighting inflation while striving to expand both employment and production above what would be regarded as maximum levels in normal peacetime.

What we do about private credit expansion and about the Government securities market is, of course, only a part of the problem that confronts us. A successful program for achieving production growth and economic stability in these critical times must be based upon much broader considerations.

We must make a unified, consistent, and comprehensive attack upon our economic problems all along the line. Our program must include, in proper proportion, production expansion policy, manpower policy, tax policy, credit policy, debt management and

- 3 -

monetary policy, and a wide range of direct and indirect controls over materials, prices and wages. All of these policies are necessary; each of them must be used in harmony with the rest; none must be used in ways that nullify others.

We have been striving in this emergency to develop such a unified program in the public interest. Much progress has already been made, both on the production front and on the anti-inflation front. Many peacetime activities of Government, including the activities of lending and financing agencies, have been pruned down. Cutbacks of civilian supplies and allocations of essential materials have been successfully undertaken. Important expansion programs for basic materials and productive capacity needed in the defense effort have been gotten underway. Price and wage controls have been initiated. Restraints on consumer and real estate credit have been applied. Large tax increases have been enacted, and additional tax proposals are now pending. In all these fields further action is being planned and will be taken as needed.

One outstanding problem which has thus far not been solved to our complete satisfaction is that of reconciling the policies concerning public debt management and private credit control. Considering the difficulty of this problem, we should not be discouraged because an ideal solution has not yet been found. The essence of this problem is to reconcile two important objectives, neither of which can be sacrificed.

On the one hand, we must maintain stability in the Government security market and confidence in the public credit of the United States. This is important at all times. It is imperative now. We shall have to refinance the billions of dollars of Government securities which will come due later this year. We shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year, even assuming the early enactment of large additional taxes, because of the seasonal nature of tax receipts which concentrate collections in the first half of the year, and because of the inevitable lag between the imposition of new taxes and their collection by the Treasury. Such huge financial operations can be carried out

successfully only if there is full confidence in the public credit of the United States based upon a stable securities market.

On the other hand, we must curb the expansion of private loans, not only by the banking system but also by financial institutions of all types, which would add to inflationary pressures. This type of inflationary pressure must be stopped, to the greatest extent consistent with the defense effort and the achievement of its production goals.

The maintenance of stability in the Government securities market necessarily limits substantially the extent to which changes in the interest rate can be used in an attempt to curb private credit expansion. Because of this fact, much of the discussion of this problem has centered around the question of which is to be sacrificed -- stability in the Government securities market or control of private credit expansion. I am firmly convinced that this

is an erroneous statement of the problem. We need not sacrifice either.

Changing the interest rate is only one of several methods to be considered for curbing credit expansion. Through careful consideration of a much wider range of methods, I believe we can achieve a sound reconciliation in the national interest between maintaining stability and confidence in public credit operations and restraining expansion of inflationary private credit.

We have effective agencies for considering this problem and arriving at a proper solution.

Over the years, a number of important steps have been taken towards developing effective machinery for consistent and comprehensive national economic policies. One of the earliest steps in this century was the establishment of the Federal Reserve System before World War I. At that time, under far simpler conditions than those now confronting us, the Federal Reserve System was regarded as the main and central organ for economic stabilization. After World War II, in a much more complex economic situation and a much more complex framework of governmental activities affecting the economy, the

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Consequently, I am requesting the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers to study ways and means to provide the necessary restraint on private credit expansion and at the same time to make it possible to maintain stability in the market for Government securities. While this study is underway, I hope that no attempt will be made to change the interest rate pattern, so that stability in the government security market will be maintained.

Among other things, I ask that you consider specifically the

CONFIDENTIAL

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desirability of measures: (1) to limit private lending through voluntary actions by private groups, through Government-sponsored voluntary actions such as was done in a narrow field by the Capital Issues Committee of World War I, and through direct Government controls; and (2) to provide the Federal Reserve System with powers to impose additional reserve requirements on banks.

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I should like you to consider also the establishment of a committee similar to the Capital Issues Committee of World War I, but operating in a broader area. The objectives of such a Committee would be to prevail upon borrowers to reduce their spending and to curtail their borrowing, and to prevail upon lenders to limit their lending. The activities of this committee could be correlated with those of the defense agencies under Mr. Wilson with the objective of curtailing unnecessary uses of essential materials.

Furthermore, I should like you to consider the necessity and feasibility of using the powers provided in the Emergency Banking Act of 1933 to curtail lending by member banks of the Federal Reserve System. These powers are vested in the Secretary of the Treasury subject to my approval. The Secretary could by regulation delegate the administration of this program to the 12 Federal Reserve Banks, each to act in its own Federal Reserve District under some flexible procedure. The program could be extended to institutions other than member banks, if desired, by using the powers provided by the Trading with the Enemy Act.

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The Chairman of the Board of Governors of the
Federal Reserve System,
The Director of Defense Mobilization,
The Chairman of Council of Economic Advisers.

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We must maintain a stable market for the very large financing operations of the Government. At the same time, we must maintain flexible methods of dealing with private credit in order to fight inflation. We must impose restraints upon non-essential private lending and investment. At the same time, we must maintain the lending and credit facilities which are necessary to expand the industrial base for a constant build-up of our total economic strength. Instead of fighting inflation by the traditional method of directing controls toward reducing the overall level of employment and productive activity, a defense emergency imposes the harder task of fighting inflation while striving to expand both employment and production above what would be regarded as maximum levels in normal peacetime.

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On the other hand, we must curb the expansion of private loans, not only by the banking system but also by financial institutions of all types, which would add to inflationary pressures. This type of inflationary pressure must be stopped, to the greatest extent consistent with the defense effort and the achievement of its production goals.

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Under the second heading, you will recall the recommendation I made to the Congress a number of times in recent years to provide additional authority for the Federal Reserve System to establish bank reserve requirements. I should like you to consider the desirability of making that or another recommendation with the same general purpose at the present time.

You are all aware of the importance of this problem, and the need for an early resolution. I should like your study to proceed as rapidly as possible in order that I may receive your recommendations at a very early date. I am asking the Director of Defense Mobilization to arrange for calling this group together at mutually convenient times.

At the same time that we are working to solve this problem of maintaining the stability of the Government securities market and restraining private credit expansion, we shall, of course, continue vigorously to review Government lending and loan guarantee operations. Since the middle of last year, we have taken a series of steps to curtail such operations and limit them to amounts needed in this defense period. I am directing the agencies concerned to report to me by March 15 on the nature and extent of their current lending and loan guarantee activities, so that these operations may again be reviewed as part of our over-all anti-inflationary program.

Ted

February 26, 1951

MEETING IN CABINET ROOM
WHITE HOUSE
11:00 A.M.-12:00 M.

Present - The President in the Chair
Mr. C. E. Wilson, Director, Office of Defense Mobilization
Mr. Leon Keyserling, Chairman, Council of Economic Advisers
Mr. John D. Clark, Council of Economic Advisers
Mr. Roy Blough, Council of Economic Advisers
Mr. Harry McDonald, Chairman, SEC
Mr. Thomas McCabe, Chairman, FRB
Mr. Allan Sproul, President, New York Federal Reserve
Mr. Edward Foley, Under Secretary of Treasury
Mr. Wm. McC. Martin, Jr., Assistant Secretary of Treasury
Mr. Charles Murphy, White House Staff
Mr. David Bell, White House Staff

The President opened the meeting in the most pleasant and conciliatory manner, and stated that he had been worried with this problem for some time and wished to get this group together for the purpose of frank and open discussion of the problems. He said that the RFC (obviously mis-spoken as he clearly intended the CEA) and the Treasury Staff had been working on some ideas which seemed to him to make a lot of sense and so he wanted to take the liberty of reading them to the group.

This he did, very clearly and with emphasis on certain points, such as the importance of the public credit of the United States, which he said several times was vital to Mr. Wilson's work, and so important that unless it were maintained the Russians would have achieved their purpose completely. Mr. Wilson nodded agreement.

After the President finished, he said that he wanted frank and open discussion of the ideas in the memorandum.

Mr. McDonald opened the discussion by passing around a memorandum on the volume of new securities and indicating that Municipal financing in particular had boomed. The President thought this very interesting.

Mr. Clark spoke next. He said the President's comments made good sense to him and recalled historical situations, such as the one calling for the creation of the Federal Reserve System and the Banking Act of 1933. He felt we might have a similar type of situation today and the powers required to meet the current problem should be studied. He thought the Treasury position in the matter of interest rates sound and appropriate in the light of mobilization efforts and the Federal Reserve certainly ought not to drive rates up by selling in the market and should work with the Treasury to keep confidence in a stable orderly market and that later in the year after tax receipts which were going to be large wherein more money for investment would appear and the financing problem would be possible of solution at current levels.

Mr. Sproul spoke next. He stated there was no disagreement on maintaining the credit of the government. If the Federal Reserve had anything to reproach itself on to date, it was the dilatory actions it had taken to restrict bank reserves. The System should have stopped net-buying governments on the scale it has been doing so long ago. This, he said, under current conditions, was monetizing the debt in a way which strained the conscience of the Open Market Committee with respect to their responsibilities. He did not think the actions contemplated by the Committee would impair confidence in

the markets as most of these securities were marketable and held by experienced investors who were used to the hazards of the market and expected it. In fact, he was of the opinion that elimination of existing artificialities and more dependence on the market itself would generate confidence and improve the outlook for the refinancing and new money issues which the Treasury would be faced with later in the year.

Mr. McCabe spoke next. He started off by stressing the element of time. He was interested in the memorandum the President had read from, and he would be particularly pleased to have the support of other agencies of the Government for increased reserve requirements. Up to date, he had never been able to obtain any support for this. However, he was concerned at the moment with the necessity for making a decision on operations in the market for which the Open Market Committee was pressing.

He then spoke of the fine work that had been done by Bill Martin and Win Riefner in trying to see if there was an area of agreement that could be worked out. He thought both Treasury and Federal Reserve were opposed to monetization of debt and they ought to be able to get together on a program.

He stressed the fact that life insurance companies and corporations and other large non-banking investors had purchased the long-term restricteds at par and now were in a position to cash them in at a handsome profit to make good on their commitments, while purchasers of savings bonds could only cash in their securities at the face price and by sacrificing the interest to maturity.

He wanted to emphasize to the President the clear purpose of the Open Market Committee to maintain an orderly and stable market but to depend as

far as possible on the judgment of the market itself. The Federal Reserve had a statutory responsibility given to it by Congress, and he felt that they must act on their judgment in the matter and despite his best efforts, he had been unable to arrive at an understanding with the Secretary of the Treasury, who is now in the hospital. He was very sorry the Secretary was in the hospital, but thought that time was very important and they ought not to be asked to delay indefinitely. Mr. Foley had called him and suggested that they might delay two weeks which, coming on top of a previous delay of two weeks, meant roughly thirty days without any action. He urged the President to appreciate how sincere they were in endeavoring to stop inflation and protect the purchasing power of the dollar but how apprehensive they were about the way things were developing.

Mr. Foley spoke next. He said he wanted to clarify a point Mr. McCabe had made with respect to the Secretary which was perhaps due to a misunderstanding. It was possible the Secretary might be able to engage in negotiations before two weeks were up but he had expressed to Mr. McCabe, whom he had tried to get repeatedly over the weekend without success until late Sunday evening, how anxious he was not to upset the Secretary unduly. On Friday neither he nor Mr. Martin had been able to see the Secretary as there was some evidence that a possible hemorrhage might occur in the eye and the Doctors refused to permit anyone to see him. The constant visits for instructions which he and Mr. Martin and others in the Treasury had been forced to make during the past week had unquestionably retarded his recovery and in asking for two weeks time of Mr. McCabe, he was merely making an estimate of what he thought would be desirable without intending to close the door to negotiations more immediately.

He then stated the Treasury's fear that lowering the pegs in the long-term restricted issues would unsettle the market, bring an avalanche of selling, and seriously impair public confidence in the issues. He said the debt was very large and that we were very apprehensive of creating any unnecessary danger which would make it difficult to refinance or obtain new money. He pointed out that the debt was now \$257 million and a panic in the market would be a catastrophe.

He stated that the conversations which had been conducted at the technical levels appeared to be making some progress and there was a fine spirit of cooperation and good will on both sides. He hoped that these could be continued and that ultimately they might be brought to a successful understanding which would benefit both the Treasury and the Federal. He thought it vital that everything possible be done to maintain stability in the market.

Mr. Keyserling spoke next. He said he had listened carefully to what had been said by his colleague Mr. Clark, Mr. Sproul, Mr. McCabe, and Mr. Foley and without commenting on what had been said, he wanted the President to know that he didn't think the problem was being faced. He felt that it was important to determine whether there was a forum or vehicle by which two clearly opposing positions could be resolved by ~~men~~ of good will. He took that to be the purpose of this meeting, and he thought it important that a real effort be made to work out this specific problem.

The President then commented that he thought it was very important to work it out and was very vital to Mr. Wilson's work, and he was very anxious to get everybody together -- that's why he was asking for this frank discussion. He was not trying to reach a decision today but hoped this would not work out the way Wage Stabilization did where a fight had developed with everyone

resigning. He didn't want to take arbitrary action, but he had certain powers and there came a point when he would have to exercise them.

Mr. Wilson spoke up -- said he didn't think it was necessary to delay this matter too long, and he wondered if we couldn't contact the Secretary of the Treasury about this particular matter promptly. Mr. Foley interjected that he was sure that could be done, and he hoped that if Mr. Wilson would undertake to get the ball in motion and get the task forces or subcommittees set up, he knew the Secretary would be most appreciative.

There seemed to be general agreement that this would be a good idea and the meeting broke up a little after twelve with the President asking that an effort be made to report to him as promptly as possible.

Wm. McC. Martin, Jr.

Tuesday

50,000

2.75

250000

100000

1,250,000

50,000

2.75

250000

350000

100000

1,3750000

1,375

1,375

26th - White House meeting - afternoon Secretary

27th - Wilson, Foley & I see Secretary 11:00 A.M.

Return for lunch

Back to see Secretary at 2:00 P.M.

Foley calls McCabe 6:00 P.M.

Resume conversations with Riefler at my house
at 8:30 - talk till 11:30

28th Talk Bartlett in morning

lunch Riefler at 12:45 Met Club

3:00 P.M. Foley, Lynch & I visit Secretary and
I got over proposal step by step
and am given authority to proceed.

March 1st Ed Bartlett and I met with Board and
Open market Committee 10:15 A.M. - 12:15
Back for lunch in Treasury - Secretary
incommunicado. Bartlett returns at
3:00 P.M. - Riefler calls at 4:00
P.M. Board still in session going
slowly. Reports again at 6:45 over
till next day.

Meet at my house 8:30 - Riefler,
Bartlett & I

Talk Haas &
Bartlett & I
had with Haas.

IMMEDIATE RELEASE

FEBRUARY 26, 1951

The President met this morning with the following:

Mr. Thomas McCabe, Chairman, Board of Governors,
Federal Reserve System
Mr. Charles Wilson, Director, Office of Defense
Mobilization
Mr. Edward Foley, Under Secretary of the Treasury
Mr. Charles Murphy, Special Counsel to the President
The Council of Economic Advisers, Mr. Leon H.
Keyserling, Chairman; Mr. John D. Clark and
Mr. Roy Blough
Mr. William McChesney Martin, Assistant Secretary
of Treasury
Mr. Allan Sproul, Vice Chairman, Federal Reserve
Open Market Committee
Mr. Harry A. McDonald, Chairman, Securities and
Exchange Commission

The President read the attached memorandum to the group and there was a general discussion of the subject covered by the memorandum. The President did not ask any of those present for any commitments on the subjects under discussion, but expressed the hope that they would go ahead speedily with the study requested.

Mr. Wilson expressed the hope that a report could be made to the President within ten days or two weeks.

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CHARTS
RELATING TO
THE
MILLS PLAN
FOR
CORPORATION TAX PAYMENTS

The Chase National Bank
of the City of New York

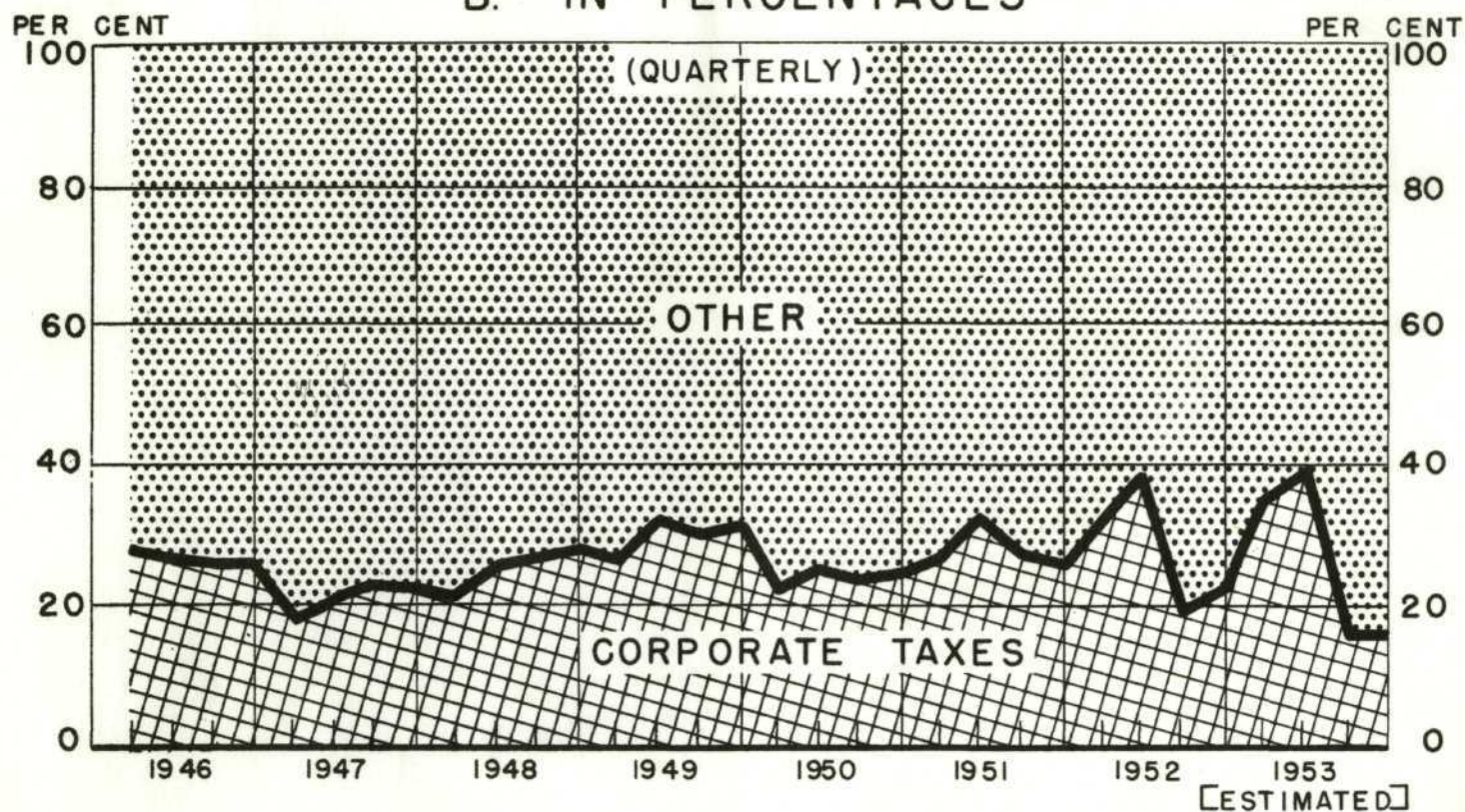
November, 1952.

FEDERAL CASH OPERATING INCOME

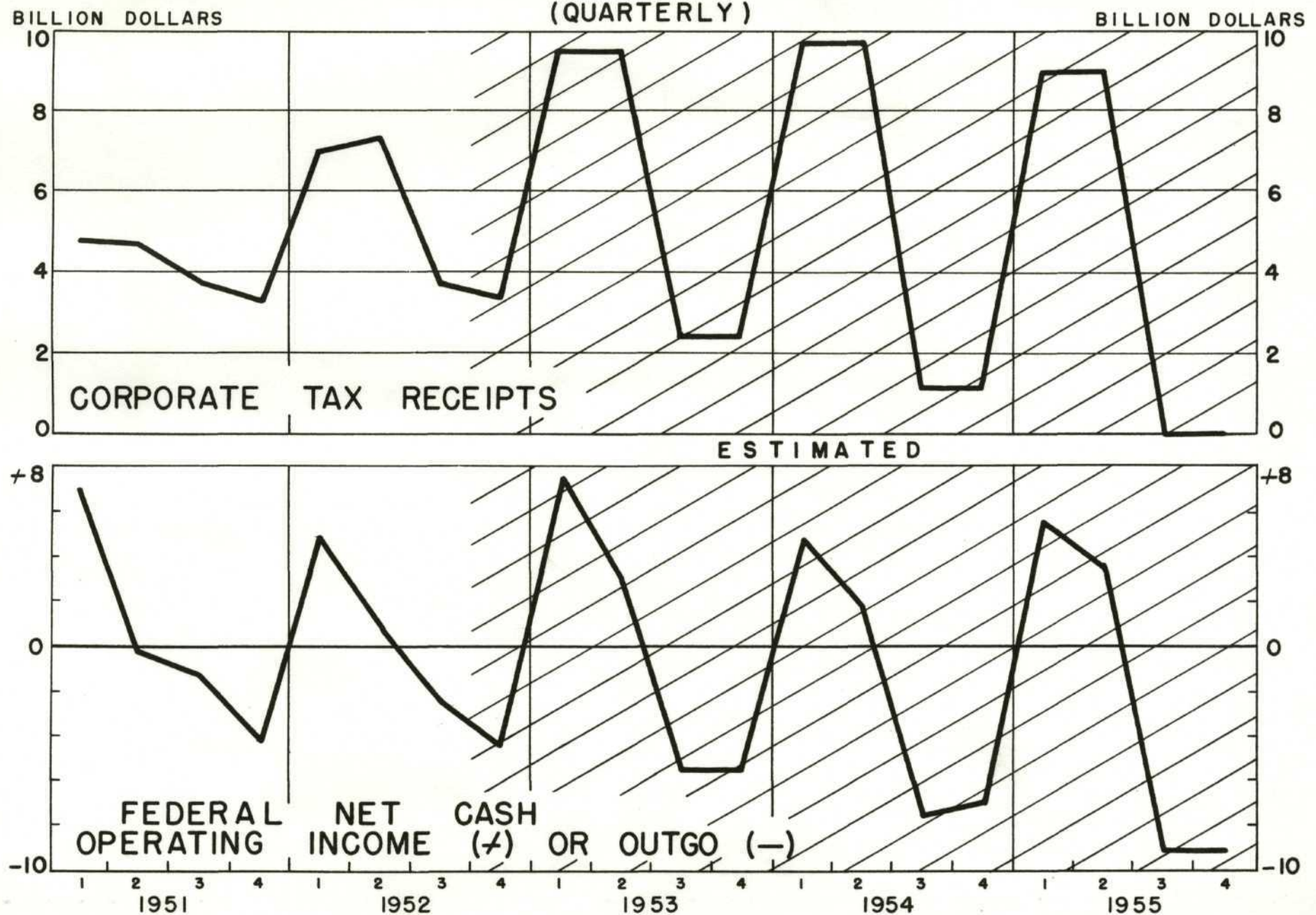
A. AMOUNTS



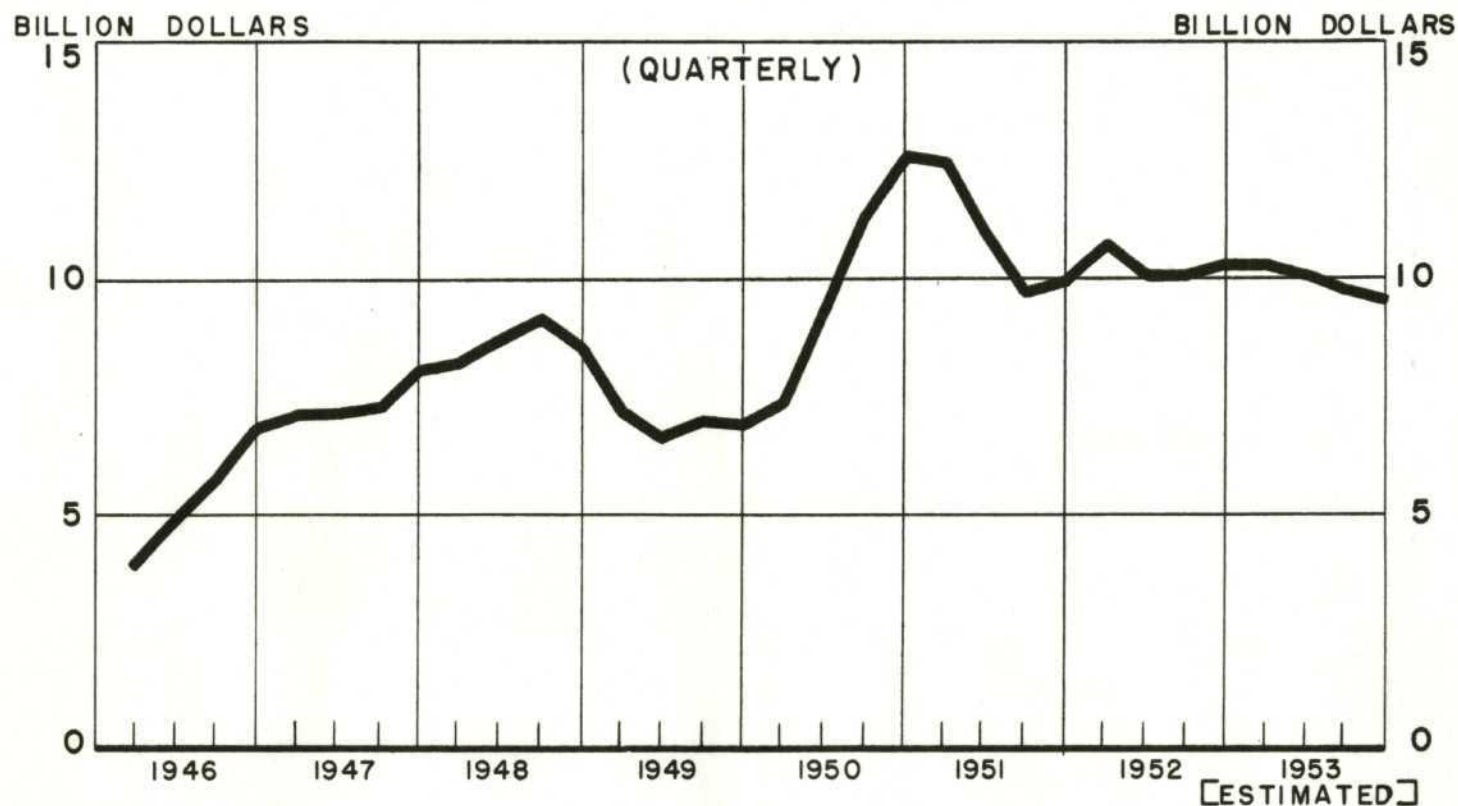
B. IN PERCENTAGES



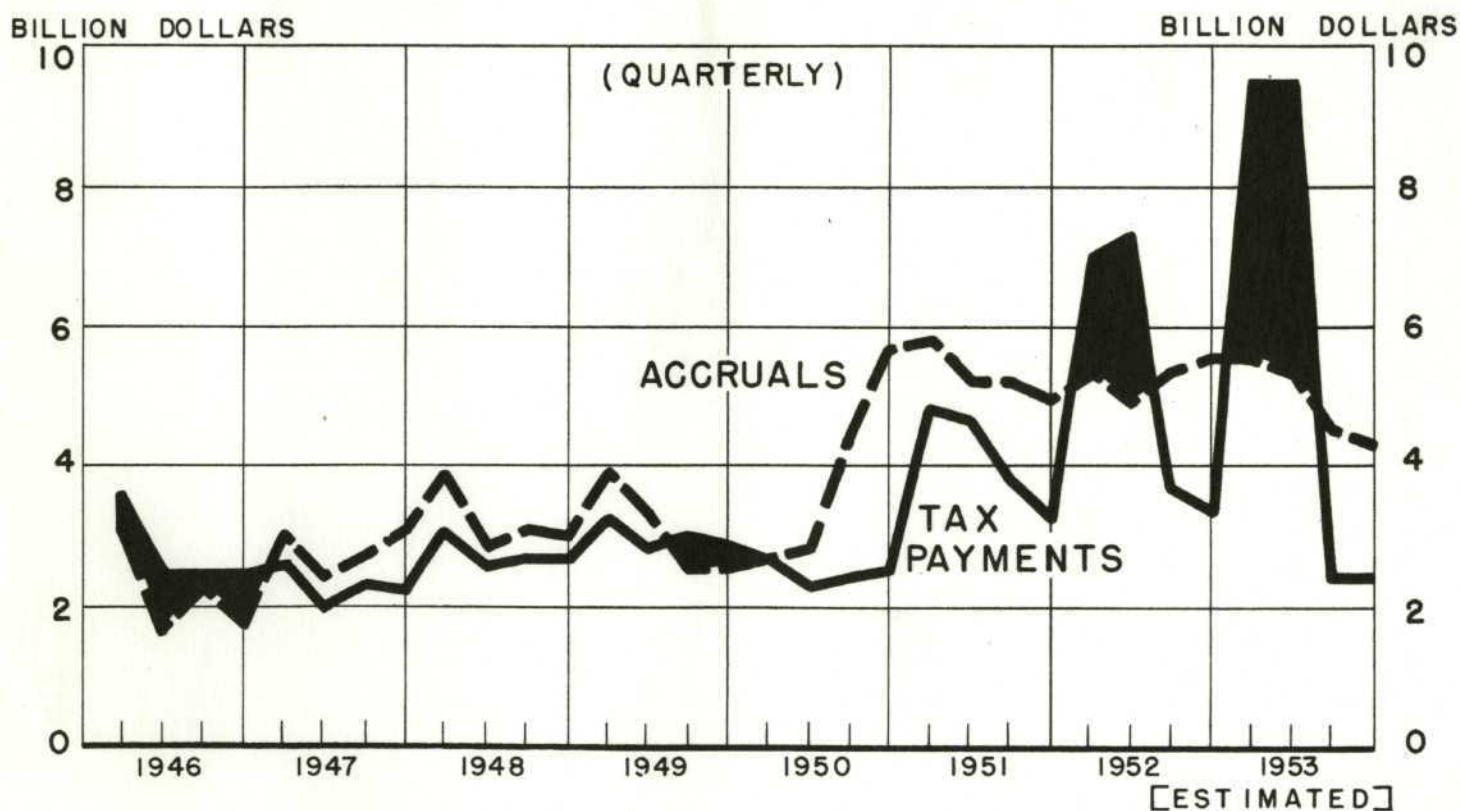
CORPORATE TAX RECEIPTS & FEDERAL NET CASH INCOME OR OUTGO



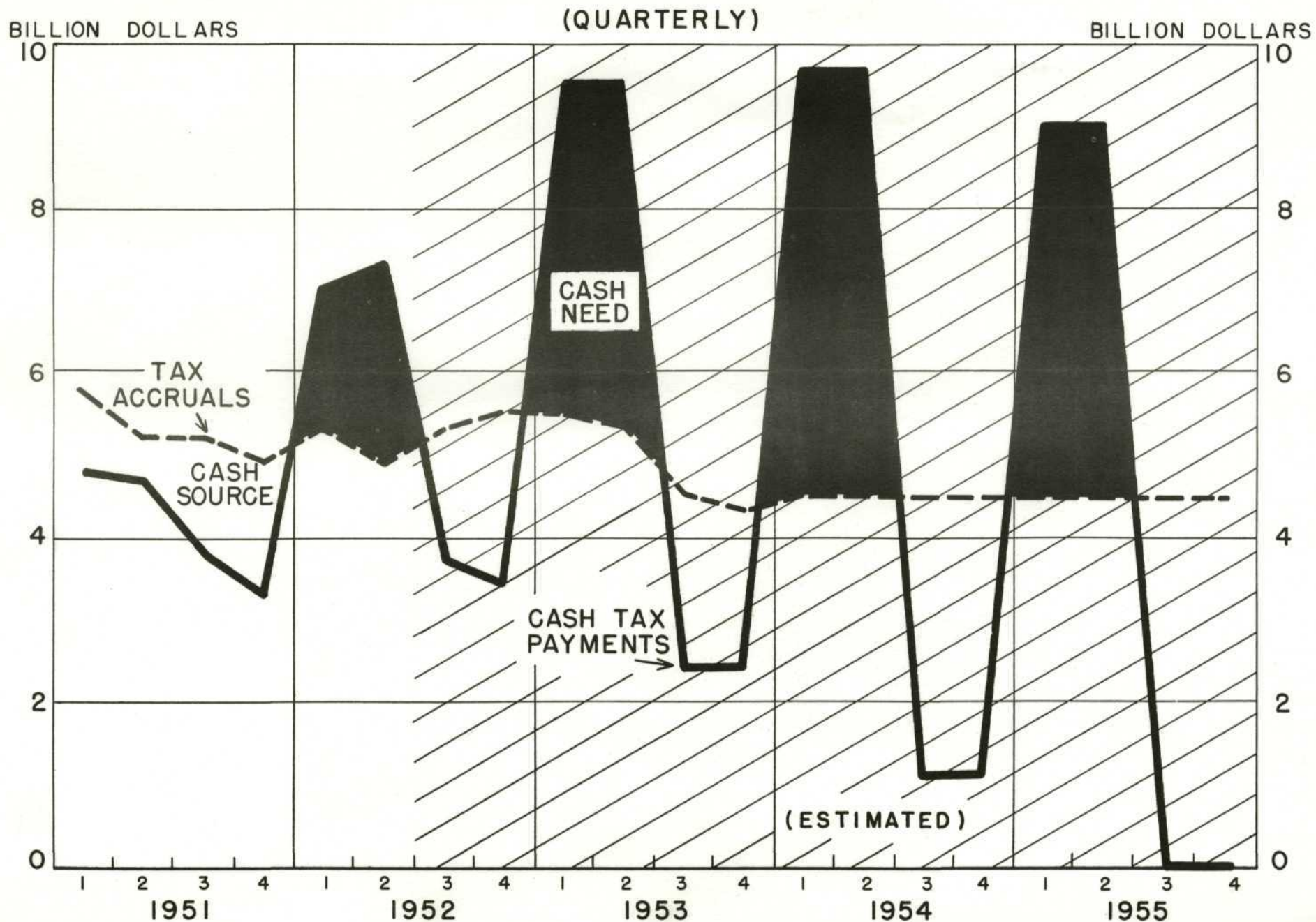
CORPORATE GROSS PROFITS



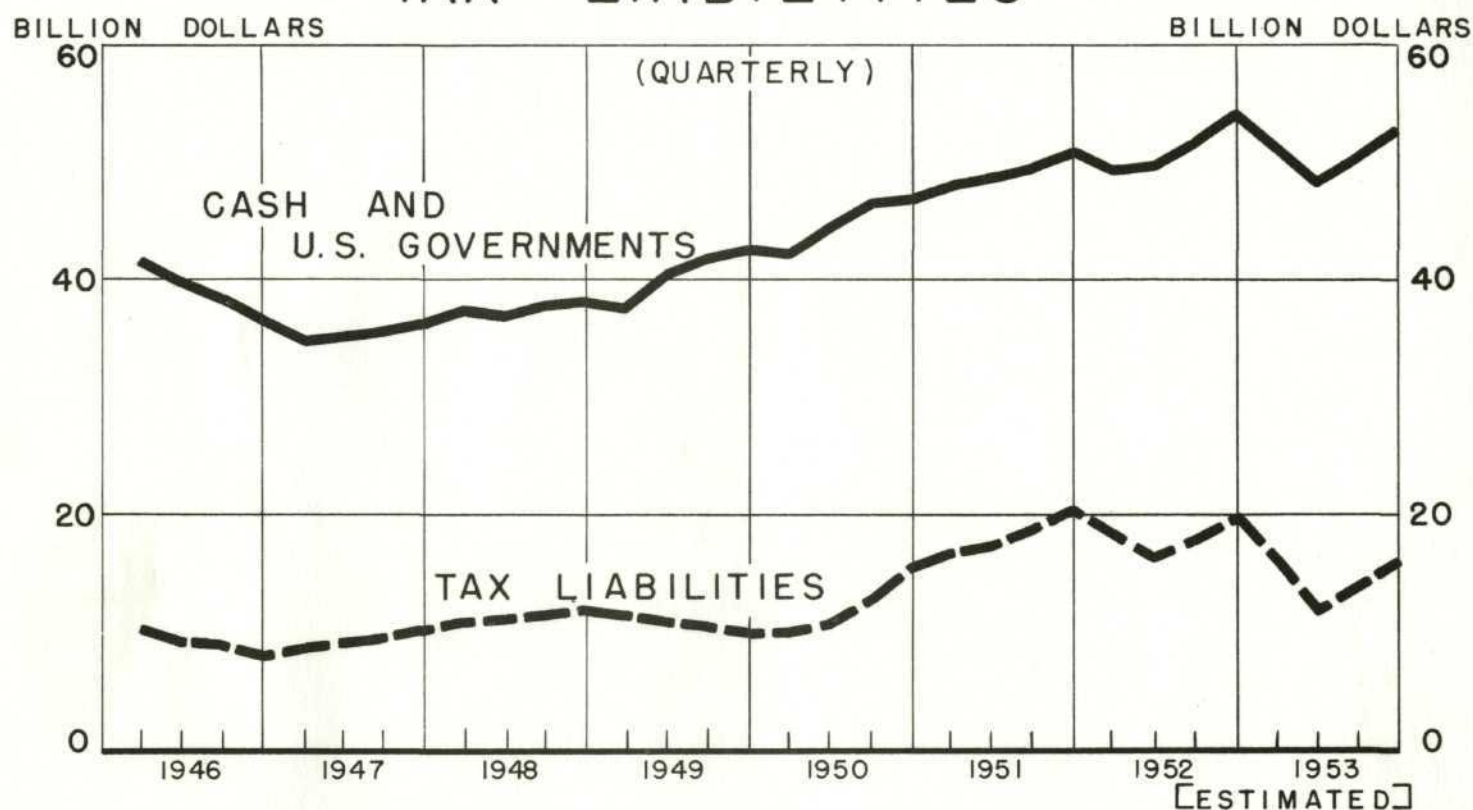
CORPORATE TAX PAYMENTS AND ACCRUALS



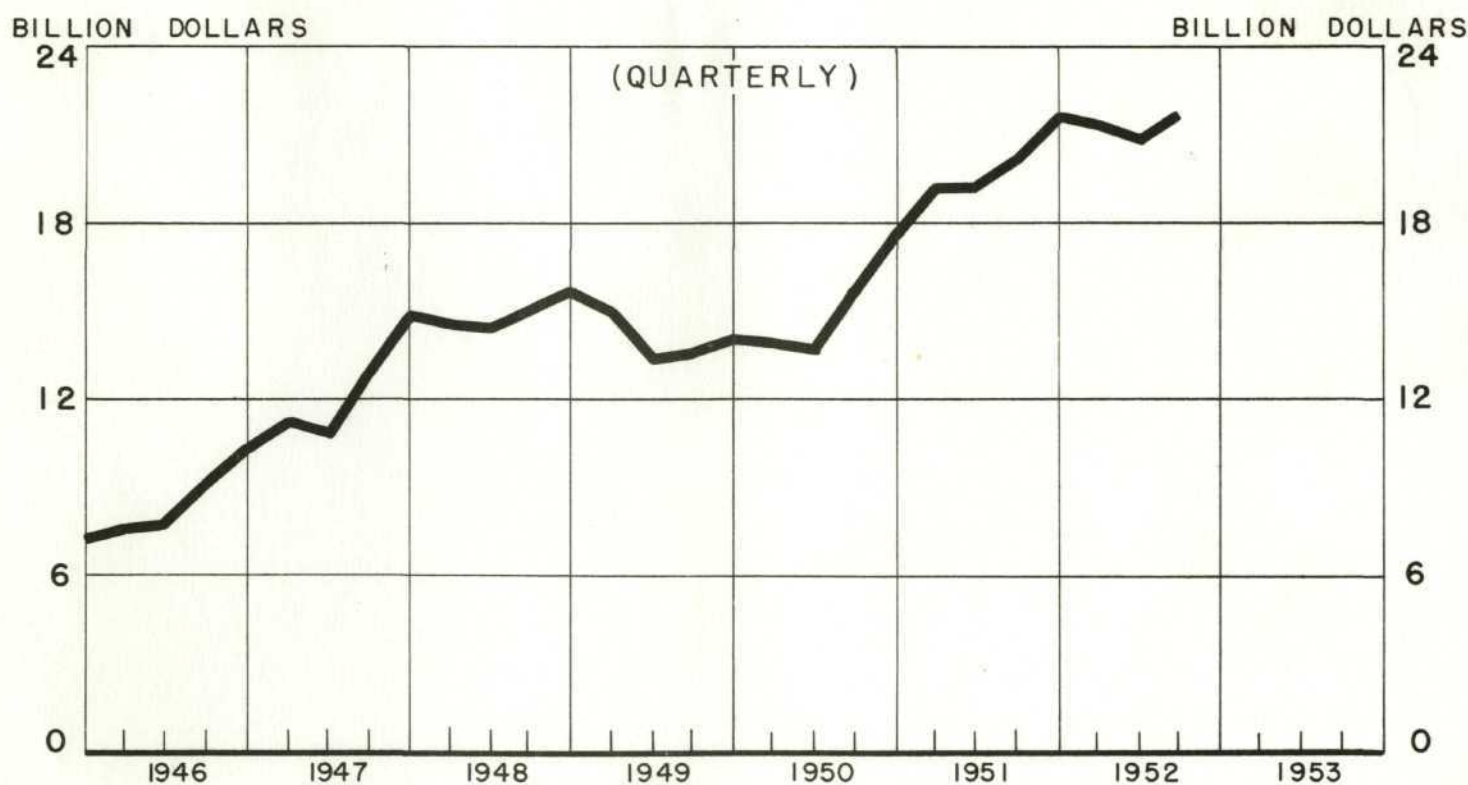
CORPORATION FEDERAL TAX PAYMENTS AND ACCRUALS, 1951-1955



CORPORATE CASH ASSETS AND TAX LIABILITIES



COMMERCIAL BANK LOANS TO BUSINESS

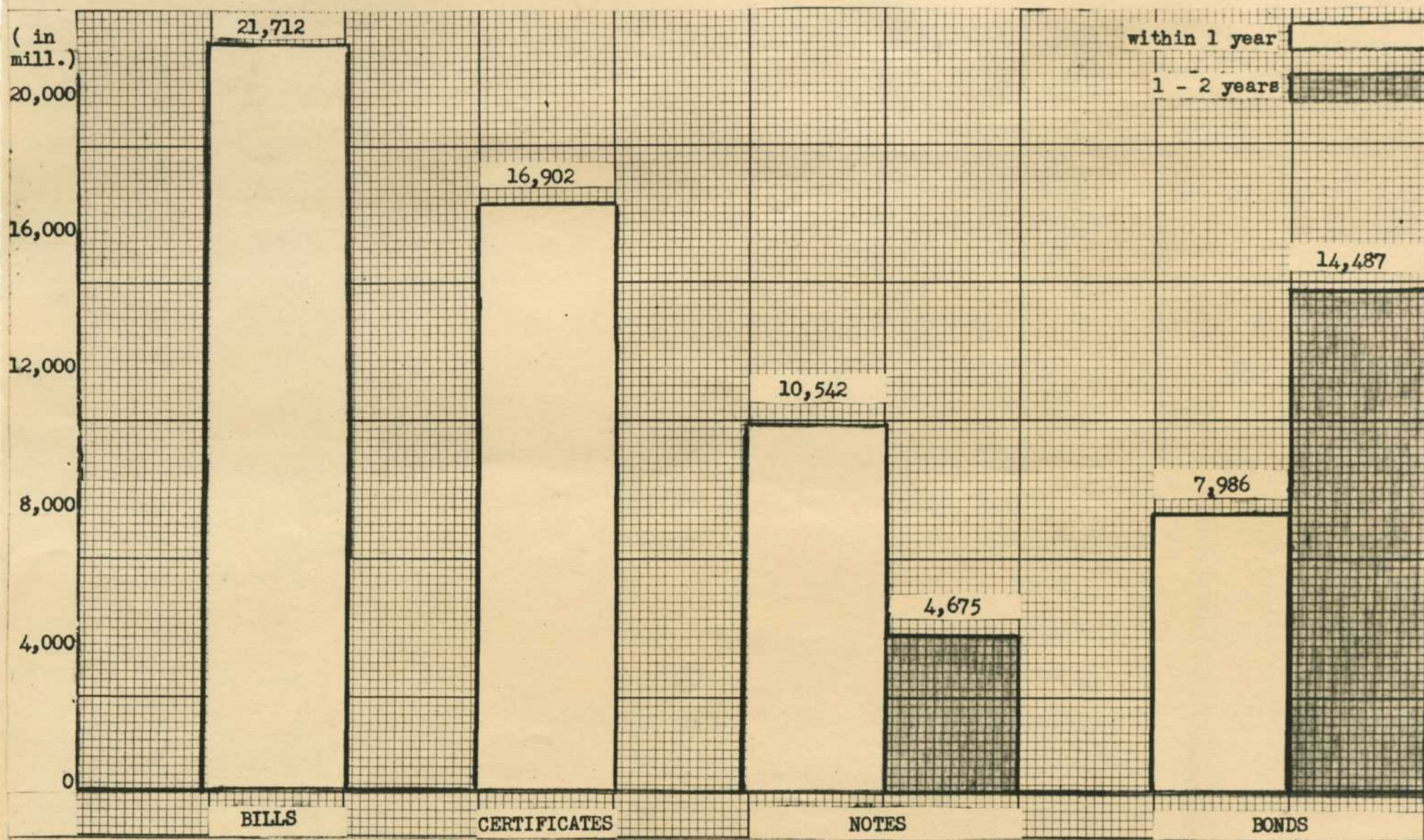


INTEREST BEARING PUBLIC MARKETABLE U.S. TREASURY SECURITIES

OUTSTANDING DECEMBER 15, 1952

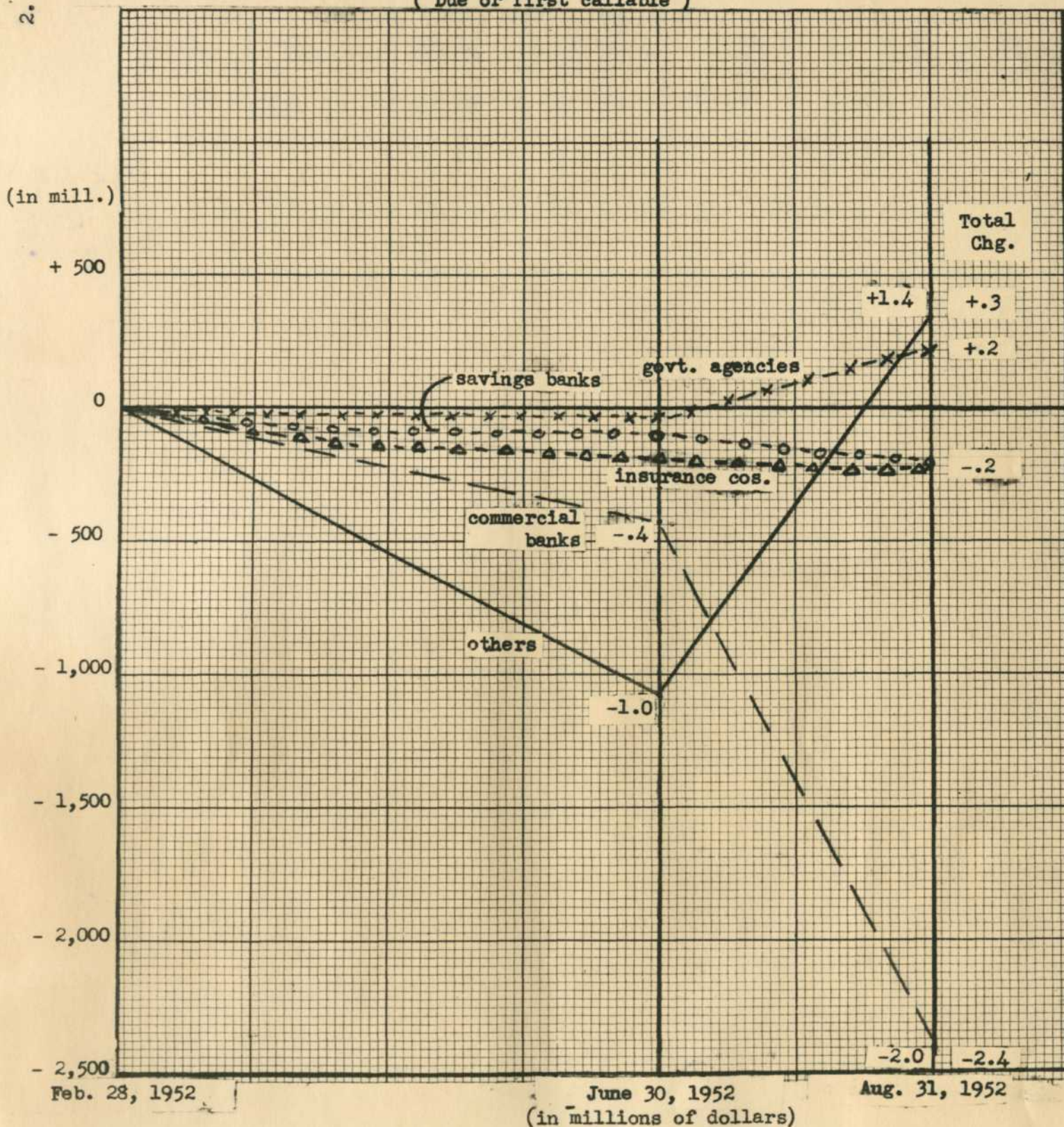
(Due within 1 year and due within 1-2 years)

1.



	(millions of dollars)			
within 1 yr.	21,712	16,902	10,542	7,986
1 - 2 years	--	--	4,675	14,487
within 2 years	21,712	16,902	15,217	22,473
over 2 yrs.	--	--	15,029	57,309
total outstanding	21,712	16,902	30,246	79,782

INTEREST BEARING PUBLIC MARKETABLE U.S. TREASURY SECURITIES
CHANGES IN HOLDINGS OF 1 YEAR DEBT
(Due or first callable)



	<u>Total</u>	<u>Comm. Banks</u>	<u>Savings Banks</u>	<u>Insurance Cos. Life</u>	<u>Fire</u>	<u>Govt. Agencies</u>	<u>Others</u>
February 28, 1952	72,784	29,973	624	774	1,210	13,986	26,216
June 30, 1952	70,944	29,540	550	638	1,106	13,968	25,143
August 31, 1952	70,519	27,556	444	640	1,121	14,200	26,558

TABLE I

<u>Date</u>	<u>Books Open</u>	<u>Maturing Issue</u>	<u>Type</u>	<u>Series</u>	<u>Exchange Offered Into</u>	<u>Type & Series</u>	<u>Maturity</u>	<u>Amount of Maturing Issue Outstanding (million)</u>	<u>Amount Not Exchanged</u>
1/1/50	12/19/49	1 1/4 Jan. 1, 1950	C. of I.	A	1 1/8-1/1/51	Ctf.-A	12 mo.	5,695	322
2/1/50	1/20/50	1 1/4 Feb. 1, 1950	C. of I.	B	1 1/4-10/1/51	Note-A	20 mo.	1,993	75
3/1/50	2/17/50	1 1/4 Mar. 1, 1950	C. of I.	C	1 1/4-7/1/51	Note-B	16 mo.	2,922	180
4/1/50	3/20/50	1 1/4 Apr. 1, 1950	C. of I.	D	1 1/4-7/1/51	Note-C	15 mo.	963	76
6/1/50	5/22/50	1 1/4 June 1, 1950	C. of I.	E	1 1/4-7/1/51	Note-D	13 mo.	5,019	201
7/1/50	6/21/50	1 1/4 July 1, 1950	C. of I.	F	1 1/4-8/1/51	Note-E	13 mo.	5,601	250
9/15/50	9/5/50	1 1/8 Sept. 15, 1950	C. of I.	G	1 1/4-10/15/51	Note-F	13 mo.	1,197	158
"	"	2 1/2 Sept. 15, 1950- 1952	Bond		" "	" " " "		1,186	281
"	"	2 Sept. 15, 1950-52	Bond		" "	" " " "		4,939	942
10/1/50	9/18/50	1 1/8 Oct. 1, 1950	C. of I.	H	1 1/4-11/1/51	Note-G	13 mo.	6,248	995
6/15/51	6/4/51	2 3/4 June 15, 1951- 1954	Bond		1 7/8-4/1/52	Ctf.-A	9 1/2 mo.	1,627	110
"	"	1 1/4 July 1, 1951	Note	B	" "	" " " "		2,741	134
"	"	1 1/4 July 1, 1951	Note	C	" "	" " " "		886	55
"	"	1 1/4 July 1, 1951	Note	D	" "	" " " "		4,818	248
8/1/51	7/16/51	1 1/4 Aug. 1, 1951	Note	E	1 7/8-7/1/52	Ctf.-B	11 mo.	5,351	135
9/15/51	9/4/51	3 Sept. 15, 1951-55	Bond		1 7/8-8/15/52	Ctf.-C	11 mo.	755	172
10/1/51	9/18/51	1 1/4 Oct. 1, 1951	Note	A	1 7/8-9/1/52	Ctf.-D	11 mo.	1,918	86
10/15/51	10/1/51	1 1/4 Oct. 15, 1951	Note	F	1 7/8-10/1/52	Ctf.-E	11 1/2 mo.	5,941	67
"	"	1 1/4 Nov. 1, 1951	Note	G	" "	" " " "		5,253	265
12/15/51	12/3/51	2 1/4 Dec. 15, 1951- 1953	Bond		1 7/8-12/1/52	Ctf.-F	11 1/2 mo.	1,118	55

<u>Date</u>	<u>Books Open</u>	<u>Maturing Issue</u>	<u>Type</u>	<u>Series</u>	<u>Exchange Offered Into</u>	<u>Type & Series</u>	<u>Maturity</u>	<u>Amount of Maturing Issue Outstanding</u>	<u>Amount Not Exchanged</u>
3/1/52	2/18/52	1 7/8 Apr. 1, 1952	C. of I.	A	1 7/8-2/15/53	Ctf.-A	11 1/2 mo.	9,524	656
7/1/52	6/16/52	1 7/8 July 1, 1952	C. of I.	B	1 7/8-6/1/53	Ctf.-B	11 mo.	5,216	253
8/15/52	8/4/52	1 7/8 Aug. 15, 1952	C. of I.	C	2-8/15/53	Ctf.-C	12 mo.	583	150p
"	"	1 7/8 Sept. 1, 1952	C. of I.	D	" " " "	Ctf.-C	" "	1,832	258p
10/1/52	9/15/52	1 7/8 Oct. 1, 1952	C. of I.	E	2 1/8-12/1/53	Note-A	14 mo.	10,861	318p

TREASURY SURVEY OF OWNERSHIP, AUGUST 31, 1952

The Treasury Survey of Ownership covers securities issued by the United States Government and by Federal agencies. The banks and insurance companies included in the Survey account for approximately 95 percent of such securities held by all banks and insurance companies in the United States. Data were first published for March 31, 1941, in the May 1941 "Treasury Bulletin".

Information on the distribution of ownership by types of banks and insurance companies is published each month. Additional information showing the holdings of commercial banks distributed according to Federal Reserve member-bank classes and nonmember banks is published for June 30 and December 31.

Section I.- Securities Issued or Guaranteed by the United States Government

Table 1.- Summary of All Securities

(Par values - in millions of dollars)

Classification	Total amount outstanding	Held by investors covered in Treasury Survey					Held by all other investors 3/
		7,113 commercial banks 1/ 2/	526 mutual savings banks 1/	Insurance companies		U. S. Government investment accounts and Federal Reserve Banks	
				317 life	606 fire, casualty, and marine		
Interest-bearing securities:							
Public marketable.....	144,186	54,380	7,642	6,517	4,171	25,577	45,900
Public nonmarketable 4/.....	78,605	2,214	2,073	3,784	1,009	4,280	65,245
Special issues.....	38,307	-	-	-	-	38,307	-
Total interest-bearing securities.....	261,098	56,594	9,715	10,301	5,180	68,164	111,144
Matured debt and debt bearing no interest 5/.....	2,127						
Total securities issued or guaranteed by the U. S. Government 6/.....	263,225						

Footnotes at end of Section II.

Table 2.- Summary of Interest-Bearing Public Marketable Securities

(Par values - in millions of dollars)

Classification	Total amount outstanding	Held by investors covered in Treasury Survey					Held by all other investors 3/
		7,113 commercial banks 1/ 2/	526 mutual savings banks 1/	Insurance companies		U. S. Government investment accounts and Federal Reserve Banks	
				317 life	606 fire, casualty, and marine		
Type of security:							
Issued by U. S. Government:							
Treasury bills.....	17,206	4,722	74	493	91	475	11,351
Certificates of indebtedness.....	28,019	6,335	90	97	377	11,969	9,151
Treasury notes.....	18,974	10,390	39	3	332	5,569	2,640
Treasury bonds - bank eligible.....	52,445	32,245	2,338	1,004	1,925	3,308	11,625
Treasury bonds - bank restricted 1/.....	27,369	664	5,092	4,912	1,443	4,227	11,030
Postal savings and Panama Canal bonds....	134	14	*	*	1	27	91
Guaranteed by U. S. Government 6/.....	38	8	9	9	*	*	11
Total.....	144,186	54,380	7,642	6,517	4,171	25,577	45,900
Call classes:							
Due or first becoming callable:							
Within 1 year.....	70,519	27,556	444	640	1,121	14,200	26,558
1 to 5 years.....	29,446	18,313	135	120	581	6,073	4,223
5 to 10 years.....	17,566	5,840	2,354	1,162	1,338	1,702	5,171
10 to 15 years.....	20,049	287	4,525	4,505	1,008	3,228	6,496
15 to 20 years.....	6,568	2,375	175	81	123	373	3,441
Over 20 years.....	-	-	-	-	-	-	-
Various (Federal Housing Administration debentures).....	38	8	9	9	*	*	11
Total.....	144,186	54,380	7,642	6,517	4,171	25,577	45,900
Tax status: 8/							
Wholly exempt from Federal income taxes.....	134	14	*	*	1	27	91
Partially exempt from Federal income taxes...	7,402	6,208	17	4	238	85	850
Subject to Federal income taxes 2/.....	136,649	48,158	7,625	6,513	3,931	25,464	44,958
Total.....	144,186	54,380	7,642	6,517	4,171	25,577	45,900

Footnotes at end of Section II.

TREASURY SURVEY OF OWNERSHIP, AUGUST 31, 1952

Section I - Securities Issued or Guaranteed by the United States Government

Table 3.- Interest-Bearing Public Marketable Securities by Issues

(Par values - in millions of dollars)

Issue (Tax status B/ is shown in parentheses)	Total amount outstand- ing	Held by investors covered in Treasury Survey					Held by all other investors 3/
		7,113 commercial banks 1/ 2/	526 mutual savings banks 1/	Insurance companies		U. S. Government investment accounts and Federal Reserve Banks	
				317 life	606 fire, casualty, and marine		
Treasury bills.....(taxable)	17,206	4,722	74	493	91	475	11,351
Certificates of indebtedness:							
1-7/8% September 1952-D.....(taxable)	262	173	4	6	3	2	74
1-7/8 October 1952-E.....(taxable)	10,861	1,163	43	24	65	6,810	2,756
1-7/8 December 1952-F.....(taxable)	1,063	509	5	-	18	5	526
1-7/8 February 1953-A.....(taxable)	8,868	1,987	19	11	115	3,757	2,979
1-7/8 June 1953-B.....(taxable)	4,963	1,737	14	56	126	1,210	1,820
2 August 1953-C.....(taxable)	2,003	767	4	1	51	185	996
Total Certificates of indebtedness.....	28,019	6,335	90	97	377	11,969	9,151
Treasury notes:							
1-3/8% March 1954-A.....(taxable)	4,675	3,431	12	1	144	245	842
1-1/2 March 1955-A.....(taxable)	5,365	4,318	18	*	94	91	845
1-3/4 December 1955-B.....(taxable)	6,854	2,578	6	2	95	3,234	940
1-1/2 April 1956-EA.....(taxable)	1,007	7	-	-	-	1,000	*
1-1/2 October 1956-EO.....(taxable)	550	40	3	-	-	500	7
1-1/2 April 1957-EA.....(taxable)	523	17	-	-	-	500	6
Total Treasury notes.....	18,974	10,390	39	3	332	5,569	2,640
Treasury bonds:							
Bank eligible:							
2% September 1951-53.....(taxable)	7,986	4,381	70	8	207	861	2,459
2 December 1951-55.....(taxable)	510	341	7	*	15	8	139
2 June 1952-54.....(taxable)	5,825	3,925	62	2	154	462	1,220
2-1/4 June 1952-55.....(taxable)	1,501	1,044	67	22	49	99	220
2 December 1952-54.....(taxable)	8,662	6,120	73	20	212	298	1,939
2 June 1953-55.....(partially)	725	679	*	*	15	*	30
2-1/4 June 1954-56.....(partially)	681	592	1	*	40	*	48
2-7/8 March 1955-60.....(partially)	2,611	1,876	3	1	79	78	574
2-1/2 March 1956-58.....(taxable)	1,449	1,163	33	10	32	22	188
2-1/4 September 1956-59.....(taxable)	3,822	2,919	29	106	62	60	647
2-3/4 September 1956-59.....(partially)	982	908	1	*	29	5	38
2-3/8 March 1957-59.....(taxable)	927	465	27	*	7	339	88
2-3/8 June 1958.....(taxable)	4,245	2,450	340	80	264	103	1,007
2-3/4 June 1958-63.....(partially)	919	835	4	*	39	1	40
2-1/4 June 1959-62.....(taxable)	5,281	548	1,191	375	539	582	2,047
2-3/4 December 1960-65.....(Partially)	1,435	1,318	8	3	36	1	120
2-1/2 June 1962-67.....(taxable)	2,118	496	390	373	132	261	466
2-1/2 September 1967-72.....(taxable)	2,716	2,186	28	6	14	127	355
Total bank eligible.....	52,445	32,245	2,338	1,004	1,925	3,308	11,625
Bank restricted: 1/							
2-1/4% December 1959-62.....(taxable)	3,468	188	421	332	326	754	1,448
2-1/2 December 1963-68.....(taxable)	2,829	34	749	572	277	364	833
2-1/2 June 1964-69.....(taxable)	3,758	35	1,332	748	176	419	1,048
2-1/2 December 1964-69.....(taxable)	3,835	31	907	1,043	202	538	1,113
2-1/2 March 1965-70.....(taxable)	4,752	57	893	1,209	181	1,141	1,311
2-1/2 March 1966-71.....(taxable)	2,976	46	426	877	123	643	860
2-1/2 June 1967-72.....(taxable)	1,899	84	257	56	48	123	1,330
2-1/2 December 1967-72.....(taxable)	3,852	189	146	75	110	246	3,086
Total bank restricted.....	27,369	664	5,092	4,912	1,443	4,227	11,030
Total Treasury bonds.....	79,814	32,910	7,430	5,916	3,368	7,536	22,655

Footnotes at end of Section II.

(Continued on following page)

TREASURY SURVEY OF OWNERSHIP, AUGUST 31, 1952

Section I - Securities Issued or Guaranteed by the United States Government
Table 3.- Interest-Bearing Public Marketable Securities by Issues - (Continued)
 (Par values - in millions of dollars)

Issue (Tax status <u>8/</u> is shown in parentheses)	Total amount outstand- ing	Held by investors covered in Treasury Survey					Held by all other investors 3/
		7,113 commercial banks 1/ 2/	526 mutual savings banks 1/	Insurance companies		U. S. Government investment accounts and Federal Reserve Banks	
				317 life	606 fire, casualty, and marine		
Other bonds:							
Postal savings bonds.....(wholly)	84	9	*	*	*	27	48
Panama Canal bonds.....(wholly)	50	6	-	-	1	*	43
Total other bonds.....	134	14	*	*	1	27	91
Guaranteed securities: 6/							
Federal Housing Administration debentures.....(taxable 10/)	38	8	9	9	*	*	11
Total public marketable securities.....	144,186	54,380	7,642	6,517	4,171	25,577	45,900

Footnotes at end of Section II.

Table 4.- Interest-Bearing Public Nonmarketable Securities by Issues
 (Par values - in millions of dollars)

Issue (Tax status <u>8/</u> is shown in parentheses)	Total amount outstand- ing	Held by investors covered in Treasury Survey					Held by all other investors 3/
		7,113 commercial banks 1/ 2/	526 mutual savings banks 1/	Insurance companies		U. S. Government investment accounts and Federal Reserve Banks	
				317 life	606 fire, casualty, and marine		
United States savings bonds:							
Series E 4/.....(taxable)	34,926	-	-	-	-	1	34,925
Series F 4/.....(taxable)	3,838	447	17	38	83	1	3,253
Series G.....(taxable)	18,687	925	568	277	454	19	16,444
Series H.....(taxable)	93	-	-	-	-	-	93
Series J 4/.....(taxable)	44	2	1	1	2	-	37
Series K.....(taxable)	165	1	4	2	7	*	151
Total United States savings bonds.....	57,753	1,375	590	318	546	21	54,904
Other U. S. securities:							
Treasury savings notes.....(taxable)	6,330	72	*	*	64	7	6,187
Depository bonds.....(taxable)	385	385 11/	*	-	-	-	-
Treasury bonds:							
Investment Series A.....(taxable)	951	189	123	301	37	100	202
Investment Series B.....(taxable)	13,186	193	1,360	3,165	363	4,152	3,952
Total other U. S. securities.....	20,892	839 11/	1,483	3,466	463	4,259	10,341
Guaranteed securities: 6/							
Commodity Credit Corporation demand obligations.....(taxable)	*	12/	-	-	-	-	12/
Total public nonmarketable securities 12/.....	78,605	2,214 11/	2,073	3,784	1,009	4,280	65,245

Footnotes at end of Section II.

INTEREST BEARING
PUBLIC MARKETABLE U. S. TREASURY SECURITIES
OUTSTANDING DEC. 15, 1952
(million dollars)

Due within 1 year

Bills		\$21,712
Certificates & Notes		
1 7/8-A - Feb. 15, 1953	\$ 8,868	
1 7/8-B - June 1, 1953	4,963	
2 -C - Aug. 15, 1953	(3,071e)	
2 1/8-A - Dec. 1, 1953 N	<u>10,542</u>	
Total C. of I.'s & Notes		27,444
Treasury Bonds		
2's - 9-15-53	7,986	
Total Bonds		<u>7,986</u>

TOTAL MARKETABLE OBLIGATIONS ACTUALLY
DUE WITHIN 1 YEAR

\$57,142Due in 1 - 2 years

Notes		
1 3/8 - 3-15-54	\$ 4,675	
Total Notes		4,675
Treasury Bonds		
2's - 6-15-54/52	5,825	
2's - 12-15-54/52	<u>8,662</u>	
Total Bonds		<u>14,487</u>

TOTAL MARKETABLE OBLIGATIONS DUE IN 1 - 2 YEARS

\$19,162Additional - Callable Within 2 years

Bonds		
2 1/4 - 6-15-55/52	\$ 1,501	
2 - 12-15-55/52	510	
2 - 6-15-55/53x	725	
2 1/4 - 6-15-56/54x	<u>681</u>	
Total Bonds		<u>\$ 3,417</u>

Due or Callable after 2 years to 5 years

Notes		
1 1/2 - 3-15-55	\$ 5,365	
1 3/4 - 12-15-55	6,854	
1 1/2 - 4/1/56	1,007	
1 1/2 - 10/1/56	550	
1 1/2 - 4/1/57	531	
1 1/2 - 10/1/57	<u>722</u>	
Total Notes		\$15,029

Bonds

2 7/8 - 3-15-60/55x	\$ 2,611
2 1/2 - 3-15-58/56	1,449
2 1/4 - 9-15-59/56	3,822
2 3/4 - 9-15-59/56x	982
2 3/8 - 3-15-59/57	<u>927</u>
Total Bonds	

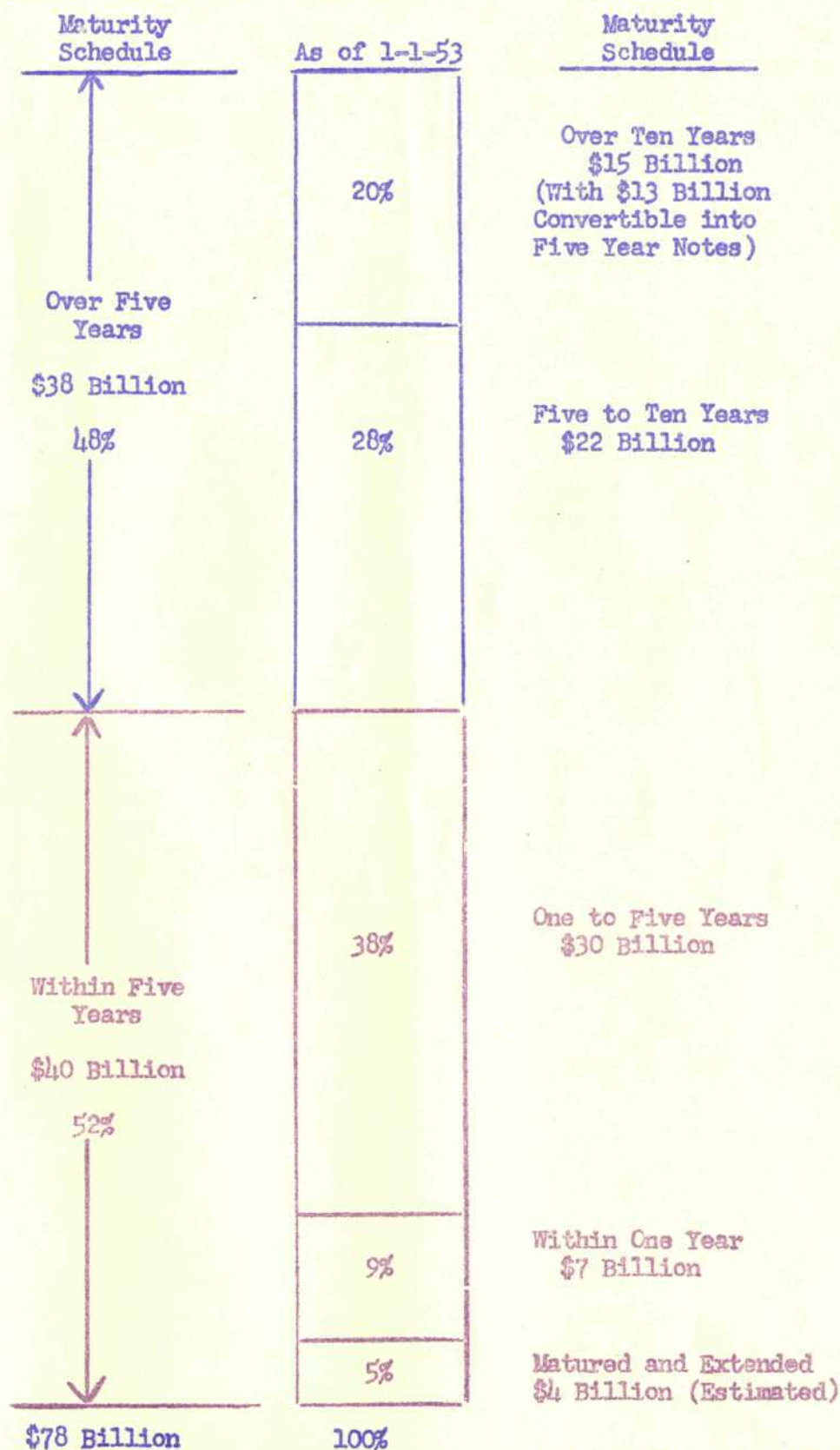
\$ 9,791

TOTAL DUE OR CALLABLE AFTER 2 YEARS TO 5 YEARS

\$24,820

STRUCTURE OF U. S. PUBLIC NON-MARKETABLE DEBT*

Total Redeemable at Option of Holder	\$65 Billion
Total Convertible into Five Year Notes	<u>13 Billion</u>
Total Non-Marketable Public Debt	\$78 Billion



Prepared by National City
Bank of Cleveland 11-18-52

* Maturity schedule based
on final due date.

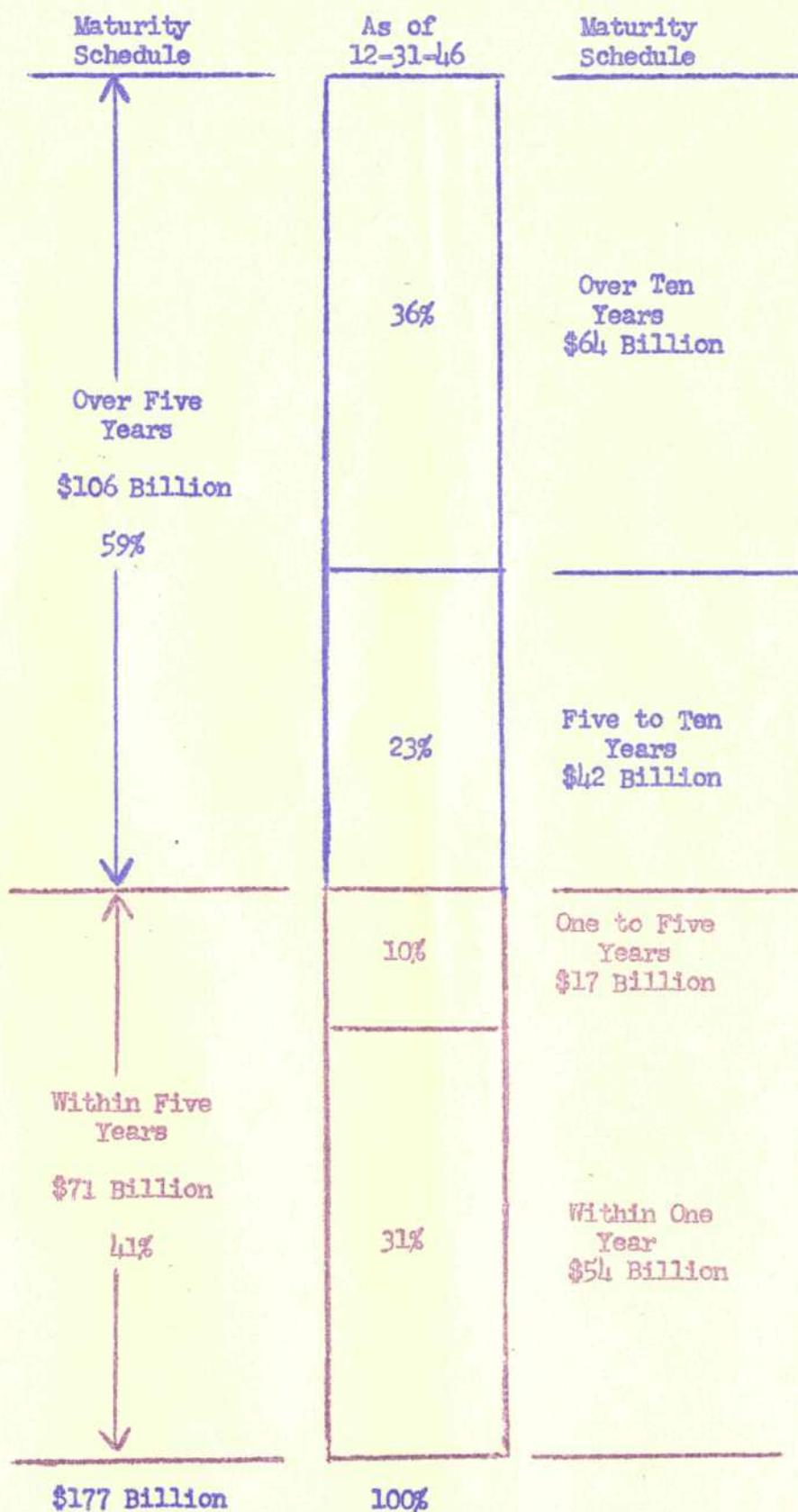
STRUCTURE OF U. S. PUBLIC NON-MARKETABLE DEBT*

	<u>1-1-53</u> <u>(Millions)</u>	
<u>Maturing Over 10 Years</u>		
Series F Bonds	\$ 158	
Series J Bonds	53	
Series G Bonds	772	
Series K Bonds	195	
Investment Series A 1965 Bonds	951	
Investment Series B 1980-75 Bonds	<u>13,182</u>	
	\$15,311	19.5%
<u>Maturing 5 to 10 Years</u>		
Series E Bonds	\$11,452	
Series H Bonds	116	
Series F Bonds	1,485	
Series G Bonds	<u>9,148</u>	
	\$22,201	28.3%
<u>Maturing 1 to 5 Years</u>		
Series E Bonds	\$14,568	
Series F Bonds	1,997	
Series G Bonds	7,761	
Series A Savings Notes	5,446	
Series D Savings Notes	<u>82</u>	
	\$29,854	38.1%
<u>Maturing Within 1 Year</u>		
Series E Bonds	\$ 5,040	
Series F Bonds	189	
Series G Bonds	946	
Series D Savings Notes	511	
Series A Savings Notes	0	
Depository Bonds	<u>390</u>	
	\$ 7,077	9.0%
<u>Matured and Extended</u>	\$ 3,878	5.0%
 Total Non-Marketable Debt:	 \$78,321	 100.0%

Prepared by National City
Bank of Cleveland 11-18-52

* Maturity schedule based
on final due date.

STRUCTURE OF U. S. PUBLIC MARKETABLE DEBT*

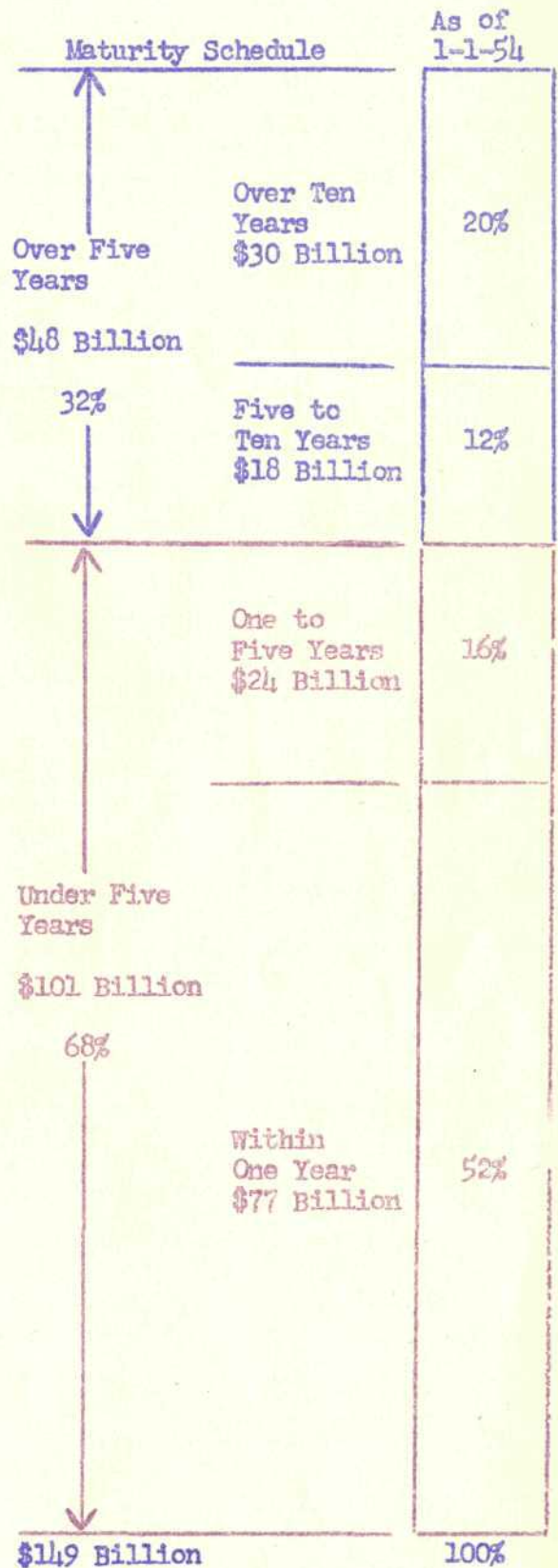
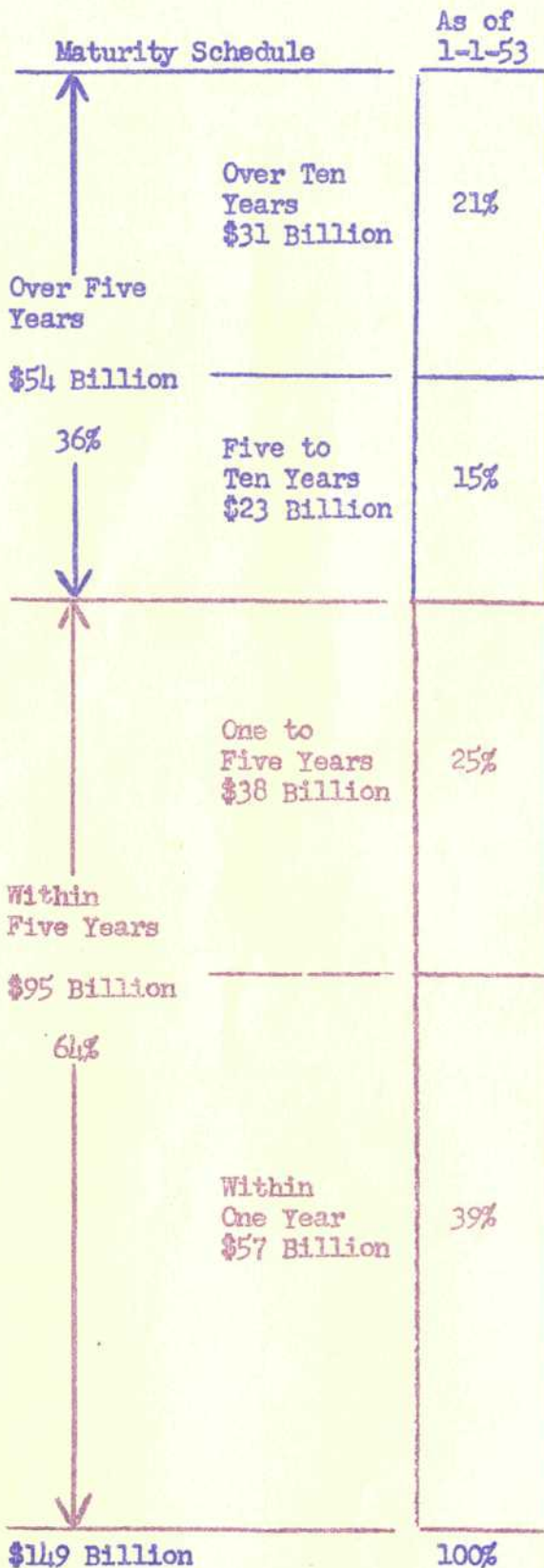


Prepared by National City
Bank of Cleveland 11-18-52

* Maturity schedule based
on final due date.

STRUCTURE OF U. S. PUBLIC MARKETABLE DEBT*

Note: Projection of the marketable debt structure as of 1-1-54 is made on the assumption that maturities would be refunded with securities due before 1-1-55.



Prepared by National City
Bank of Cleveland 11-18-52

* Maturity schedule based
on final due date.

DRAFT

August 3, 1951
WWR-ET

My dear Mr. President:

It is now five full months since the Treasury and Federal Reserve reached an accord, a sufficient interval to judge the action with some perspective. I was intimately involved from the Treasury side in the preliminary discussions that led to the accord, and have tried in my present position at the Federal Reserve to operate faithfully under it. I am moved, accordingly, to make this report to you.

The real meaning of the accord lay in its spirit. It did not attempt to prejudge the future or to settle by argument and debate the relative merits of the issues that were then dividing the two institutions. Rather, both agreed to work conscientiously together to meet constructively the pressing problems that were before us. The country was in the throes of an active inflation at a time when the fiscal problems that faced the Government in refunding and new money financing were stupendous. Neither of us wanted to see further monetization of the debt. We knew that meant more inflation. Both were concerned to assure the efficient financing of the Government. In the true spirit of the accord, we have worked together to assure the success of the Treasury financing program with a minimum monetization of the debt.

Looking back over the five months, I think it is fair to say that the economy has been in equilibrium at a high level of activity. During this period it has accommodated a large transfer of resources from civilian to defense production without further inflation. During this

period also savings have begun once more to accumulate in savings institutions. The Treasury has financed successfully two major maturities, and confidence has returned to the market for Government securities.

I realize that there are sharp differences of opinion among your advisers with respect to how much the accord has contributed to this happy result. Without pressing my own view as to its importance, I think that most fair-minded people would agree on two propositions: (1) That we would not have experienced this period of equilibrium without the accord, and (2) that this interval in the inflationary spiral has given the Government its first real chance to organize itself to meet effectively the economic problems arising out of the defense program.

Respectfully yours,

Wm. McC. Martin, Jr.,
Chairman.

The President,
The White House.

C.F.R. 5%

- 2.7
6.1

11.5
5.6

D 1 Jan
- Feb
March 5
April - 14
May 1
J 1

AGENDA FOR MEETING OF GOVERNMENTAL SECURITIES COMMITTEE

N.R. 6/12
3-5

Morning Session

- I Forecast of Receipts and Expenditures
Estimate of New Money Requirements

} 6/12 J, 30 53
3-5

- II Availability of Funds

+2

- III Debt Structure
Long Term Financing

P. equip 23.5-52
22. 53

- IV Savings Bonds

1.5
1.5
Two Receiv
Corko Forks -

4.8
+5 200M. may be available
M. G. P. - - -
Schoans 3.2-3 +500 b

Afternoon Session

- I Market Techniques

2.30
Fixed Cas +200

- III Treasury Refundings

25% less committed

- III Mills Plan

November 21, 1952.