

February 26, 1951

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 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 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 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. 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 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.

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 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.

(Sgd) HARRY S. TRUMAN