A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Wednesday, January 31, 1951, at 10:00 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Erickson
Mr. Evans
Mr. Norton
Mr. Peyton
Mr. Powell
Mr. Szymczak
Mr. Vardaman
Mr. C. S. Young

Mr. Carpenter, Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. R. A. Young, Director, Division of Research and Statistics, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. R. F. Leach, Economist, Division of Research and Statistics, Board of Governors
Mr. Arthur Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 27, 1950 were approved.

> Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee held on November 17 and 27 and December 27 were approved, ratified, and confirmed.

Mr. Rouse presented and commented upon a report of open market operations prepared at the Federal Reserve Bank of New York covering the period from November 27, 1950 to January 24, 1951, inclusive, and a supplementary report covering commitments executed from January 25 to January 30, 1951, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

In commenting on the reports, Mr. Rouse stated that late last week the volume of offerings of the longest restricted 2-1/2 per cent Treasury bonds increased and that demand for such bonds was not sufficient to absorb the supply, with the result that approximately $30 million of bonds were purchased for the System account in accordance with the policy approved at the meeting of the Committee on November 27, 1950. In view of the increase in selling, Mr. Rouse said, he conferred informally with Chairman McCabe and Mr. Sproul and it was felt that no change should be made in the existing policy, i.e., that the longest-term restricted bond would not be allowed to decline beyond a point slightly above par, and that an orderly market would be maintained. Mr. Rouse went on to say that early on Monday afternoon of this week the price of the longest restricted bonds was allowed to decline 1/32 of a point to par and 21/32, and that shortly he received a telephone call from Mr. Bartelt, Fiscal Assistant Secretary of the Treasury, who stated he had talked with the

Secretary of the Treasury about purchase of the longest bonds for trust accounts of the Government, and asked Mr. Rouse's view about the Treasury giving the New York bank as fiscal agent of the United States an order to purchase such bonds at par and 22/32. Mr. Rouse said he replied that in the past such orders had always been given to the Bank for execution at the market and that the market was par and 21/32, and that he would not be interested in having an order on any other basis. Subsequently, Mr. Rouse said, Mr. Bartelt called him on the telephone again and read the following telegram which was being sent to Mr. Sproul by the Secretary of the Treasury:

> "As fiscal agent of the United States, you are authorized and requested to purchase for account of the Postal Savings System not more than two hundred million dollars Treasury bonds December 1967-72 at par and 22/32nds, plus commission, at such times when open market purchases are not made at this price for open market account."

Mr. Rouse added that yesterday purchases of the December 1967-72 Treasury bonds at par and 22/32, plus commission, pursuant to the wire from the Secretary of the Treasury totalled $32,400,000 and that $500,000 June 67-72's were purchased for the System account at par and 21/32. He also outlined the reasons for the recent increase in market rates on bankers' acceptances.

> Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period November 26, 1950 to January 30, 1951, inclusive, were approved, ratified, and confirmed.

Chairman McCabe then called upon Mr. Sproul who made a statement substantially as follows:

Chairman McCabe and I met with the Secretary of the Treasury on January 3, 1951. The Secretary had indicated that it would be desirable for us to have frequent conversations and discussions about debt management and credit policy in the light of the existing situation and we immediately sought this meeting. Mr. Bartelt, Fiscal Assistant Secretary of the Treasury, was also present. We made it clear to the Secretary that there had been no meeting of the Federal Open Market Committee since November 27, that we were, therefore, talking with him as individuals, and that it was expected we would have a full and free exchange of views so that we could, at a subsequent meeting of the Federal Open Market Committee, discuss what coordinated policy of credit and debt management could be developed. I had some notes which I had made beforehand and made a statement to the Secretary based on those notes. I said there is danger that:

1. We will try to get mobilization and rearmament wholly as a by-product of a continuing peace-time business boom. This is the tempting idea of increased production, increased national income, and increased Government revenues, which will take care of our civilian and military needs without civilian sacrifice and Government borrowing. It would relieve the pressure for cuts in nondefense Government expenditures and for some reduction in ivilian consumption. Resilience and expansive power of our economy is great, but time is a controlling factor. The economy is already stretched and the necessary increases in production can't be expected in 1951 even if work hours are increased, the number of workers expanded, and normal productivity gains are obtained. An inflationary stimulus under such circumstances would raise prices not production.

2. Reliance will come to be placed too largely on direct controls, and stern resolves about fiscal and credit policy will be forgotten. Both kinds of controls now appear to be needed, but the exemption of agricultural prices and softness toward wage increases, weaken direct controls, which will fail, in any case, unless backed by strong fiscal and credit measures.

3. We won't tax enough and in the right places (in order to cut down consumer purchasing power not savings) and we won't have the wisdom or the power to apply credit controls effectively

Admittedly, too high taxes may dull incentive or may themselves become inflationary, through union pressure for higher wages or corporate action to raise prices, or lowered management interest in cost control. It is not likely, however, that the necessary tax increases to meet Government expenditures during the calendar year 1951 will breach these points.

Admittedly, credit controls, by themselves, cannot wholly check inflationary pressures when other strong forces are working to increase costs and prices, but we must do all we can to hold down the money supply, and that means we should use general or quantitative controls which affect interest rates, as well as selective controls. The next six months, while the Treasury will be largely out of the market, offer the best chance to get our house in order, through general credit measures. After that the requirements of credit policy and Government financing needs -refunding and new money - may be in conflict and financing needs will take precedence.

4. Looking ahead to tremendous armament expenditures over a period of years, and talking about plans and appropriations instead of cash outlay, we may lose sight of the fact that the problem is still of manageable proportions, as of the year 1951. If we hit an annual rate of Government spending for defense of $45 billion by the end of calendar 1951, the cash deficit on the basis of present tax rates (omitting the just passed excess profits tax) would still be only about $6 billion. It is too early to dismiss pay-as-you-go as merely a pious proposal, and to talk of tremendous deficit financing, and of a frozen pattern of interest rates to hop up the Government security market.

It is in the light of these present dangers, and in preparation for meeting the more difficult longer term problems of financing full scale mobilization or war, that near term policy should be determined.

5. If present inflationary advances in the credit sector continue, as it appears they may during the next few months, further action to restrict the availability of bank reserves would be in order. Whether this is accomplished through open market operations or further power (and use of that power) to increase reserve requirements, or both, it must have some influence on interest rates to be effective. This would impose a further marginal tightening in the availability of credit, and it would permit the Federal Reserve System to offer additional resistance to the unloading of shorter term securities on the Open Market Account. In terms of longer range objectives, it would also move us closer to a horizontal yield curve, which will tend to "pin in" existing holders of Government securities and prevent playing of the pattern of rates in the period of renewed deficit financing which may lie further ahead.

6. The immediate problem of debt management is in the area of long term rates, and includes the problem of maturing savings bonds and the sale of new savings bonds.

The lesson to be learned from the financing of the last war is that long term financing at rates which won't hold up in the market, without Federal Reserve support, is to be avoided. This suggests a slightly higher rate than 2-1/2 per cent for long term financing. The attraction of a slightly higher yield (almost regardless of maturity), particularly for institutional investors facing actuarial income requirements, could effect a significant diversion of new investment funds into new Treasury issues. Such investors will not, of course, neglect attractive alternative private investments, but the competitive position of Treasury offerings would be greatly improved, having in mind the desire of these investors to find the safest lodgment for their funds consistent with their actuarial requirements.

In a technical sense, also, the Treasury will face a problem unless it offers a higher long term rate. The fact that present outstanding restricted issues running only 17 years to call date, have to be heavily supported, suggests strongly that no net sales of new securities of longer maturity, at the same rate, would be possible. Nor would it be desirable, in terms of orderly debt management to place any more new bonds within this 17 year period.

In terms of immediate as well as longer term debt management, as well as credit policy, this suggests that if market pressures continue the price of outstanding restricted bonds of 1967-72 be allowed to decline to par, or only slightly above, so that they may stand on their own feet as soon as possible, so that forced injections of reserve credit into the banking system may be stopped, and so that the ground will be prepared for the long term financing which lies ahead. Never before has the Treasury faced unknown new borrowing requirements in the face of a very large outstanding debt. If it is to obtain new money from long term investors rather than merely effect a churning about in old holdings it must break away from old patterns. The only way to reduce switching of outstanding securities into new Treasury offerings will be through Treasury action to set a higher long term rate, and through removing the premium on the longest term outstanding restricted bonds. In the long run debt management (as well as credit policy) must be judged by the success of new offerings in attracting savings.

Mere switching out of old issues into new, with actual requirements being met, indirectly, by bank money carries an explosive charge of inflationary pressure that could disrupt all other Government efforts to control inflation.

7. Savings bonds. Since 1951 marks the beginning of substantial maturities of savings bonds, methods of encouraging retention and stimulating further sales will have to be worked out very soon. Terms on this type of security, sold to the general public, cannot practicably be changed except infrequently; consequently changes worked out in 1951 should be designed to meet requirements for some years ahead.

A System Committee has been working on this problem for some time, and has now been directed by the Federal Open Market Committee to discuss its ideas with the Treasury staff. It is hoped that out of these consultations will come recommendations which the Committee can promptly submit to you. So far as thinking has gone it suggests among other things that terms of present E bonds be revamped, and that individuals be offered, in automatic extension of existing holdings and for cash, a bond which will return about 1/2 of 1 per cent more if held to maturity.

In addition to improving the terms of savings bonds, it seems to me only slightly less important to revitalize the savings bond sales organization, and to provide it with sufficient appropriated funds to do an aggressive, all-out selling job. Consumer incomes will continue to rise in excess of currently available goods, we won't tax away the whole of the excess, and we must attract some of this excess into savings or it will express itself in higher prices, thus undermining the whole savings bond program.

8. This is a program for the immediate future, which also looks ahead to the time when large Government deficits may make necessary a fixed pattern of Government financing and some recourse to the banking system to meet the Government's needs. At that time we shall need to have at least three things:

(a) A method of bank financing which will cut down or eliminate the leverage in the fractional reserve system; short term rates then in effect need not be the rates applied to bank borrowing, which may well have to be fixed, arbitrarily, at some lower level.

(b) A long term bond which will attract new investment funds (other than individual) and which will take care of itself in the market under ordinary conditions. It may be that some form of compulsion will become necessary in this area, also, to assure continued holding.

(c) A savings bond which will attract and hold individual savings. The possibility of a refundable tax - or compulsory saving - should be again explored.

In preparing for this longer term program we should continually keep in mind that it may (we hope) lack the stimulus of actual war, and that it may be of indefinite duration. We must avoid, in so far as possible, doing those things which have been excused during past wars as the lesser of the evils which temporarily we faced.

The Secretary listened very attentively to what we had to say, but gave back to us no comparable outline of his thinking on debt management or credit policy. I certainly left the meeting with the clear understanding and expectation that this was the first of a series of frequent consultations in which we would get his views which we would be able to report back to this Committee, and then present to him our thinking in the form of views of the Committee, rather than as individual members of the Committee, and how those views might be adapted to whatever debt management program might be developed.

Chairman McCabe then made substantially the following statement:

Following that discussion we brought up the report prepared by the staff on the Series E savings bond program and asked the Secretary how he would like to have that handled; whether he would like to have the Federal Open Market Committee consider the matter and make a recommendation, or to have the staff report as it was. He suggested that we send the staff report to Mr. Bartelt and let him discuss it with their staff, after which he would determine whether he wanted a definite recommendation from us. In the course of a few days the staff did send over the very comprehensive memorandum on the study of the Series E savings bond program. Mr. Bartelt called and asked if he and Mr. Graham, Assistant Secretary of the Treasury in charge of Savings Bonds, could come over and talk with us. They came over on Tuesday, January 16, and Mr. Thomas, Mr. Riefler, Mr. Young, Mr. Youngdahl, and I sat down to lunch with them with the full expectation they would discuss all features of the program. Mr. Graham spent most of the time at lunch trying to sell us on how well the E Bond campaign was going over and the success they were meeting throughout the country. We commented generally on the E Bond campaign, and then Mr. Bartelt asked about the advisability of having savings bonds made eligible as collateral for loans. They told us their staff report was on the Secretary's desk awaiting final approval from him. In that situation, there was nothing to discuss since, so far as they were concerned, their recommendations were on the Secretary's desk. That was on Tuesday, January 16. On Thursday, January 18, the Secretary made his speech in New York to the Board of Trade in which he outlined the program for savings bonds. There certainly was not any constructive discussion of the program with us, since they told us early in the conversation at that luncheon meeting the sixteenth that their report was on the Secretary's desk.

Previous to that meeting and to our talk with the Secretary on January 3, I had received a communication from the President. This was early in December - the President telephoned me at my home about an article that had appeared in The New York Herald Tribune on December 1, 1950, which said that there was "open speculation as to whether the Federal Reserve is again undercutting the (Treasury) financing," and that it was "obviously risking another huge shakeout of long holdings such as that which followed the Christmas package of downward peg adjustments some years ago." That article seemed to have upset the President very much. He mentioned the fact that he hoped we would stick rigidly to the pegged rates on the longest bonds. I told him the dangers of that. Fortunately, I had right at my fingertips information about the restricted bonds that we had purchased and told him who the principal sellers of those bonds were. I said I could not understand why we would sit there with such a high premium and allow the life insurance companies to unload on us at such a handsome profit. Following that telephone conversation, the President wrote me a note on December 4 and said he was enclosing the article which he had called me about on the telephone. This letter read as follows:

> "I am enclosing you the article to which I referred in my telephone conversation with you Friday night.
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> "It seems to me that this situation is a very dangerous one and that the Federal Reserve Board should make it perfectly plain to the open market committee and to the New York Bankers that the peg is stabilized.
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> "I have succeeded in getting the Treasury to appreciate the fact that we should have our obligations financed on

"longer terms than has been the case generally but, if the Federal Reserve Board is going to pull the rug from under the Treasury on that, we certainly are faced with a most serious situation, because we are going to have an immense amount of Federal financing in the next six months.

"I hope the Board will realize its responsibilities and not allow the bottom to drop from under our securities. If that happens that is exactly what Mr. Stalin wants."

I replied to the President in a personal and confidential letter on December 9 as follows:

"As you can imagine, your telephone call a few days ago and your subsequent letter of December 4 gave me great concern because I was distressed that you should have another problem added to the many critical ones before you.

"The newspaper clipping to which you referred had not been previously called to my attention. I would not have considered it of special significance because it is such a distortion of the facts. We suspect that it was written by a man who we know makes a practice of baiting the Federal Reserve and creating an appearance of controversy. You can rest assured that we are fully conscious of the magnitude of the financial problems that face us, and that we will do all in our power to insure the successful financing of the Government's needs.

"You will recall that I mailed you a copy of my letter of October 30 to John Snyder in which I outlined the policy to be pursued by the Open Market Committee in accordance with the assurance which I previously gave to you and John in your office on October 26.

"We heartily subscribed to the Treasury's latest refunding announcement and I assured John Snyder that the Open Market Committee would do everything possible to make it a success. I told him that we might have to purchase between 2 billion and 4 billion dollars of the new issue before the refunding was completed, but that we were prepared to do it. I told him further that we would make every attempt to sell an equivalent amount of other securities in our portfolio in order to try to offset "purchases. Excess of purchases over sales would tend to increase bank reserves. The creation of additional bank reserves in a period like this only adds more fuel to the fire of inflation. We have conducted our operations in strict accord with the policy which I outlined to you and John.

"Actually we have purchased more than 2.5 billion dollars of the maturing issue in support of the Treasury refinancing. In addition, we have continued to buy long-term 2-1/2 per cent restricted bonds in the narrow range of from 23/32 to 26/32 above par. Since November 22 we have made a net increase in our portfolio of well over one billion dollars. We hope to sell enough Government securities in the coming weeks to offset the effects these purchases have had on bank reserves.

"You can see from these figures that we have faithfully followed the policy as outlined to you.

"It is our view that moderate fluctuations in price in response to market forces serve a useful purpose and help to maintain public confidence. Our feeling is that too rigidly pegged prices of securities encourage greater selling by investors. Our experiences over the past several months, in which we have had both rigid pegs for an extended period and slight fluctuations on the long-term restricted bonds, have convinced us that a moderate degree of flexibility is preferable. Since the end of November, covering the period when the subscription books to the new Treasury refunding issue were open, we have maintained a fixed buying price for the long-term restricted bonds.

"I would prefer not to take up with the Open Market Committee the question of notifying the New York bankers of a fixed peg until I have had an opportunity fully to discuss with you the possible adverse consequences of such an action.

"I expect to be in Birmingham, Alabama, and Chicago until December 15. I will be pleased to see you either on Friday, the 15th, or Monday, the 18th, if either of those dates is convenient to you. I can assure you that in the meantime our operations will be directed toward maintaining stability in the market."

I told the President I was leaving to be away for several days but would like to come over and see him the next week, and I did see him on December 18. I took over to him the complete day-to-day record of our performance -- what had happened to the volume of transactions during that period when the peg was held rigid and what had happened during the period when prices had dropped one or two thirty-seconds. There was nothing in the figures to indicate that we purchased more bonds when the price dropped than when the peg was rigidly maintained. I went over this in great detail with him and I got the feeling that he had confidence in what we were doing.

Then on Wednesday, January 17, 1951, I met at the White House with the President and the Secretary of the Treasury, at the President's request of the day before, and when I returned to the office I dictated the following memorandum of our conversation:

> "On Wednesday, January 17, 1951, the President asked me to meet with John Snyder in his office at 10:45 a.m. The President opened the conference by saying that he was concerned about the market for Government securities and wanted to take this opportunity to discuss with John and me what might be done as he wanted us all in complete accord on the policy to be pursued, particularly in connection with the long-term 2-1/2 per cent restricted bonds. He said, 'You know that my chief concern is the maintenance of the 2-1/2 per cent rate on these bonds.'
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> "I expressed surprise at this statement because I said that we had had a very clear understanding at the last meeting of the three of us and that following that meeting I had written a memorandum, and asked the President if he recalled it. He said he did and thought that meeting was worth while. He said that yesterday he was thinking about the subject again, mentioned it to John Snyder, and suggested that the three of us get together again.
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> "I said that I still did not understand his concern because the market was behaving very well and that our chief concern was the volume of restricted bonds which we were having to buy from insurance companies and savings banks as the purchase of these bonds resulted in the creation of reserves in the banks, which were very inflationary as the demand for bank credit was exceptionally strong. I then related several instances of bank credit expansion.

"John Snyder spoke up and said he was quite happy with the way the market had been handled recently and that there was no complaint about our operations. John said that his interest was to have a clear understanding about the maintenance of the 2-1/2 per cent rate and that it was his strong feeling that the sooner we let the public know that the 2-1/2 per cent rate was going to be maintained, the better.

"I said that since the Treasury will not need any new funds before the middle of the year that it did not seem to me that he had much of an immediate problem. He replied that he might want to offer some long-term bonds before the middle of the year if he could find a propitious time to make an offer, that his idea was that the rate should be 2-1/2 per cent. I said that there was some doubt about the market taking a 2-1/2 per cent issue for a twenty-five or thirty-year bond and that thought had already been expressed to John. He said he was thoroughly convinced in his own mind that the 2-1/2 per cent rate would be acceptable if the market could be stabilized and some of the uncertainties removed.

"I remarked again that I did not know what we were concerned about because everything, to my mind, seemed to be under control. The President reiterated his former statement, namely, 'I have been concerned about maintaining confidence in Government securities and wanted to make sure that we were in agreement about our ideas of maintaining the 2-1/2 per cent rate.'

"Snyder, at one point, interjected the thought that since he was making an announcement with regard to the E Bonds, it would materially add to the sale of the E Bonds if the public felt that the 2-1/2 per cent rate was being maintained.

"On two or three occasions I reiterated the thought that I did not see what we were concerned about. I went into some detail to tell the President about the long-term securities we have had to absorb, and when I had finished, Snyder said, 'If you had not jiggled the market the way you did a few months ago, you would not have had to absorb so many bonds from the insurance companies.' He further said, 'I think that most of the securities you have been called upon to absorb have been the result of market uncertainty.'

"Throughout the interview, I was under the impression that we were talking about current operations and "maintaining the 2-1/2 per cent rate on the outstanding points. I did not give any consideration to a public announcement on possible 2-1/2 per cent bonds to be issued in the future.

"I was shocked to read the account of Snyder's speech in New York the following day as he did not mention the speech in our conference with the President, nor did he tell us that he was going to make a public announcement."

On January 19, 1951, I added this note:

"The President told me today that he did not know about the New York speech or the proposed announcement. I think that the New York speech was very cleverly worded in its references to the President and to me, as the wording indicates that he consulted with us and then made his decision, and there is a strong inference that we concurred in the announcement. The President may have concurred in his mind, or privately, but I was not asked to concur in the public statement.

"Before seeing the President this morning, I conferred with Governors Szymczak, Evans and Norton about the points that I would raise with the President regarding the Snyder speech, and it was the strong advice of Governors Evans and Norton that I not raise an issue regarding it. Governer Szymczak felt that I should make my position clear.

"In my conference with the President this morning I devoted most of the time to a discussion of my memorandum to Charlie Wilson on inflation controls. Then at the end of the interview I spoke of my astonishment in reading the account of Snyder's speech and said that it was most unfortunate that he did not tell us of his intention to make the speech and the announcement which he proposed to make. I said I followed the policy of checking with the interested parties before the Federal Reserve made a public announcement, and in this instance I felt strongly that he should have checked the announcement with us, particularly since he used the President's name and my name. The President said he thought I was right and that he would speak to John about it.

"The President commended me highly for the way in which I cooperated with Government officials. He said he could offer no criticism of our actions. He told me also that he would have a conference shortly with Charlie Wilson on the memorandum and that he was very much impressed "with the recommendations. He seemed to be greatly concerned about inflation."

Yesterday the White House called and said that the President would like to meet with the full Federal Open Market Committee today at four o'clock. I think that we might give consideration here to the question of what the President might possibly wish to say to us and what would be our reply. I would assume, without having any knowledge of it, that he will talk about the Government bond market and that he will make a very strong appeal to the Federal Open Market Committee to back up the statement of the Secretary of the Treasury in New York on January 18.

Mr. Gilbert, alternate for Mr. Davis, joined the meeting at this point.

Chairman McCabe stated that there were three possible alternative positions that the Federal Open Market Committee might take:

(1) Assure the President that the Committee would literally carry out the program announced by the Secretary of the Treasury on January 18 of maintaining the 2-1/2 per cent long-term rate on existing and new issues of securities for the period of the emergency. This program would be made known to the public so that it would be known that the Committee was acting in response to a specific request of the President during the emergency.

(2) Assure the President that the Committee would carry out the letter and spirit of the announcement of the Secretary of the Treasury with the reservation, however, that if changing economic conditions warranted a different course of action, the Committee would make known its views to the Secretary of the Treasury and the President and urgently request that a conference be held in which the policy announced by the Secretary and agreed to by the Committee would be modified. This procedure would also be public-

ly announced.

(3) If the views that might be expressed by the President were diametrically opposed to those of the Committee, the members of the Committee could resign.

It was Chairman McCabe's view that the Committee should thoroughly discuss these alternatives.

In response to an inquiry the Chairman made the following additional comment:

> Miss Barrows, Secretary to Mr. Connelly, who is Secretary to the President, called yesterday to say that the President was very anxious to meet with the Federal Open Market Committee today at four o'clock. I asked if the meeting was to be "on the record". She transferred me to Mr. Connelly, who said he assumed it would be on the record but that he would send a note to the President. I said I thought the President should give careful consideration to this point and to any statement that might be made to the press regarding the meeting because it was very unusual for the Committee to meet with the President and it was important that the President be prepared for the comments that might be made on the meeting. I said it might be desirable if I could have a few minutes with the President before the meeting with the Federal Open Market Committee, and Mr. Connelly suggested that I come over before four o'clock. I do not know how the meeting originated and I do not know whether the Secretary of the Treasury will be there.

In this connection, there were distributed two memoranda prepared by Mr. Thomas under date of January 30, 1951, with respect to debt management and credit policy, and a memorandum on the Outlook for Bank Reserves and Treasury Cash Requirements, also dated January 30. Copies of these memoranda have been placed in the files of the Federal Open Market Committee.

There followed a general discussion in the light of the Committee's responsibility under the law, of the possible positions that it might take at the meeting with the President. In this discussion Mr. Sproul expressed the view that apparently the Secretary of the Treasury was not satisfied with the commitments that had been made by the Federal Open Market Committee, particularly its letter of October 30, 1950, and that it looked as if he had gone to the President, expressing the view that he could not get a clearly satisfactory understanding with the Committee and that he would like to have the President call the members of the Committee in and obtain assurances of the policy to be followed.

There was also a discussion of the comment that had appeared in the press recently concerning Mr. Eccles' testimony before the Joint Committee on the Economic Report on January 25, 1951, and of a call that Senator O'Mahoney, Chairman of the Joint Committee on the Economic Report, had made to Chairman McCabe yesterday with respect to Mr. Eccles' having appeared before the Committee at the request of Senator Taft. Mr. Eccles stated that Senator Taft had requested that he appear before the Committee, that he accepted, that his acceptance had nothing to do with whether Chairman McCabe appeared, that Chairman McCabe had said nothing to him about appearing in his place, and that he made it clear in his opening comments before the Committee that he had not been requested to represent the Board.

Mr. Sproul then referred to the three possible courses of action that Chairman McCabe had suggested and stated that he would add a fourth. He said that the first suggestion would leave the FederalReserve with nothing to do in the field of general credit controls as a means of getting the financial mechanism in order for a full mobilization and a possible war, and that in the present situation the second alternative would be equally bad. Under either alternative, although the Federal Reserve could impose certain selective credit controls, such controls would not do the main job Congress had given the System to do; in terms of the importance of the matter to the Federal Reserve and to the nation, the most important job was to maintain public confidence in the real value of the dollar and the Government credit and not in a fixed interest rate or in fixed prices of Government securities. He stated, therefore, that it would be his feeling that in the future, as in the past, the Federal Reserve should seek to adapt its policy to the needs of the Government and the Treasury, but that that did not mean the System should go right down the line in supporting a policy determined and set in the Treasury and announced publicly without consultation. He went on to say that he felt the System would have to maintain some flexibility in the short-term rate and that it might be necessary to consider a higher rate on long-term Government issues if that was found necessary to make them acceptable to the public. He added that he hoped, before the Treasury made a decision with respect to a new long-term issue, there would be an opportunity for the Committee to review the matter with the Secretary, particularly since he (Mr. Sproul) seriously doubted whether the market would accept new long-term issues at the 2-1/2 per cent rate announced by the Secretary on January 18 without heavy support by the Federal Reserve. Mr. Sproul said that if nothing could be accomplished along this line he did not believe resignation of the Committee to be a real alternative, since it would be an admission of failure or inability to carry out our statutory responsibilities, without giving the Congress an opportunity to review our performance and to express its will. A fourth and better alternative, he said, would be to go to Congress and ask for a new set of rules to govern the Federal Reserve System because it could not continue on the present course which involved either continued open conflict with the Treasury or complete abdication of the responsibility of the members of the Federal Open Market Committee.

Mr. Peyton raised the question whether it was necessary at this time to make a decision on the statement that would be made to the President or whether it would not be better simply to attend the meeting as requested, to listen, and subsequently to consider any suggestions the President might make. It was suggested, however, that in view of the fact that the President might be expected to inquire as to the views of the Committee concerning support of the program announced by the Secretary of the Treasury on January 18, it would be desirable to explore at this meeting the response that should be made to that question.

In the course of the discussion, Chairman McCabe read the letter sent by the Committee to the Secretary of the Treasury under date of October 30, 1950, in which it was stated that the Committee was in complete agreement that under present conditions it was necessary to protect the 2-1/2 per cent rate (par) on the longest-term Treasury bonds now outstanding but that if further inflationary or market forces should develop at any time in the future which would make it necessary for the Committee to reconsider that decision, it would feel it desirable and compelling to seek the Secretary's counsel. Chairman McCabe stated that he felt it was this statement that was giving the Secretary concern in that it appeared that the Secretary would like to be assured that any deficits that might grow out of the defense program during the next few years would be financed on the basis of a 2-1/2 per cent long-term interest rate, regardless of whether the market would support such a rate, and that the Secretary felt that the Federal Reserve should commit itself to purchasing securities to whatever extent was necessary to maintain such a rate. The Chairman went on to say that the drop of 1/32 of a point in the price of the long-term restricted bonds on Monday of this week to which Mr. Rouse referred earlier in this meeting was, in his opinion, the thing that again had made the Secretary of the Treasury uneasy as to the procedure that would be followed by the Federal Open Market Committee and that undoubtedly this was the reason for the President's request for the meeting this afternoon.

While the discussion was in progress, Mr. Thurston stated it had just been announced on the ticker that the Federal Open Market Committee would meet with the President at four o'clock.

At the end of the discussion Chairman McCabe suggested that the staff prepare a draft of statement which might be used to present the views of the Federal Open Market Committee to the President and that the Committee meet again after lunch to consider the draft.

This suggestion was approved unanimously.

Thereupon the meeting recessed and reconvened at 2:25 p.m. with the same attendance as at the close of the morning session.

The Secretary read the draft of statement that had been prepared in accordance with the discussion at the morning session. A copy of the draft has been placed in the files of the Federal Open Market Committee. In the course of a lengthy discussion of the statement, Mr. Vardaman said that he would make his views known to the President and would state that the Committee, having been requested to follow a course by the Secretary of the Treasury and by the President, had no alternative but to follow that course; that, in a period such as the present, the members of the Board ceased to be civilian officers of the Government, and that he would be guided by whatever request was made by the President as Commander-in-Chief. He then requested the Secretary to read the following statement which he had presented to the Board of Governors on January 30, 1951:

> "It is my understanding that Chairman McCabe was invited to appear, on behalf of this Board, before the Committee on the Economic Report and that Chairman O'Mahoney announced at the opening of the hearing when Governor Eccles testified, that Governor McCabe was unable to attend because of illness and absence from the city and that Governor Eccles would appear in his place. In spite of Governor Eccles' statements that he was speaking for himself personally and not for the Board, the impression seems to be that he was, unofficially at least, expressing the Board's opinion.

"As a Board member I had no notice that the Chairman had been officially requested to appear before this committee. If I had had such notice I would have urged that the Chairman or some spokesman for the Board appear before the committee and make a statement substantially as follows.

"'The Federal Reserve Board has made its recommendations to the Secretary of the Treasury in connection with the interest rate on short-term Government obligations and also with reference to the interest rate and maturities on funding and refunding bonds. In the exercise of his statutory authority and obligation, the Secretary has not thought it wise to follow all of the suggestions made by this Board in connection with these matters. Acting in his official capacity, as the spokesman for the Government, the Secretary has announced a financing program, and this Board has nothing further to say on the questions involved other than to state quite firmly and clearly that the Board will support to the fullest extent of its authority the program as officially promulgated by the United States Treasury.

"'Whenever it is in line with its statutory authority to do so, the Board will advise with the Secretary on all matters relating to the management of the public debt or any other questions which he may desire to discuss. But it should be clearly understood that under our constitutional framework and present statutory laws, the management of the public debt is the responsibility of the Secretary of the Treasury, and this Board will support him to the utmost of its ability in his officially declared programs and actions.

"'We believe the duty of this Board to be to make its ideas available and known in council, but not to make such ideas prevail and the Board will act in accordance with this belief in the present situation.'

"Under no circumstances should this Board be guilty of endeavoring to bring outside pressure to bear in an effort to have its way.

"It is my intention to offer a motion in the meeting of the Board on Tuesday, the 30th, to request the Chairman to make a public statement similar to the above, on behalf of this Board at the earliest appropriate moment."

Mr. Sproul expressed the view that Mr. Vardaman's proposed statement would make the Federal Reserve System a bureau of the Treasury and, in the light of the responsibilities placed on the System by the Congress, would be both impossible and improper. Other members of the Federal Open Market Committee indicated agreement with this view.

It appeared during the discussion that it would not be possible to perfect a statement before the meeting with the President and it was suggested that no formal statement be taken to the White House and that the Chairman be authorized to speak for the Committee, his statement to be in the light of the discussion at this meeting and the letter sent to the Secretary of the Treasury under date of October 30, 1950.

It was agreed unanimously that this procedure would be followed and the meeting recessed at 3:28 p.m.

Following the meeting with the President, the meeting reconvened in executive session at 4:50 p.m. with only the members of the Committee present. At 5:50 p.m., Messrs. Carpenter, Vest, Thomas, Rouse, Thurston, Riefler, Sherman, R. A. Young, Youngdahl, and Leach were called into the meeting.

The Chairman reported that the members of the Committee had agreed that Mr. Evans should prepare a memorandum of the meeting of the Committee with the President which, after such changes as Mr. Sproul might suggest, would be circulated to the other members of the Committee for comment and approval.

Secretary's note: This statement prepared by Mr. Evans and approved by the individual members of the Committee, was as follows:

"The full Federal Open Market Committee met with President Truman in the Cabinet Room shortly after 4:00 p.m. on Wednesday, January 31, 1951. Chairman McCabe had met with the President in his office a few minutes earlier and came into the Cabinet Room with him. The President shook hands cordially with everyone present.

"The President stated that during the past few weeks he had met with many groups in Government because he wanted them to know the seriousness of the present emergency and to ask for their full assistance and cooperation. He stated that the present emergency is the greatest this country has ever faced, including the two World Wars and all the preceding wars.

"He gave a brief sketch of the difficulty of dealing with the Russians and said they had broken 32 parts of the agreements entered into at Cairo, Potsdam, and Yalta. He mentioned that these agreements, among other things, provided for a unified Germany, unified Poland, cooperation with Nationalist China, and a unified Korea, which would select its own Government by democratic process. He stated that the Americans provided Nationalist China with about 3-1/2 billion dollars of war equipment, much of which Chinese generals and other leaders disposed of to the Communist forces. He characterized the Nationalists as being the most corrupt government in history.

"He stated that General Eisenhower's report to the Cabinet today, after his visit to 12 North Atlantic countries, emphasized the seriousness of the situation but that the General believed Europe has the will to rearm and resist with our help. He mentioned some figures about the number of troops involved, in support of his statement that the emergency is very serious indeed.

"The President emphasized that we must combat Communist influence on many fronts. He said one way to do this is to maintain confidence in the Government's credit and in Government securities. He felt that if people lose confidence in Government securities all we hope to gain from our military mobilization, and war if need be, might be jeopardized. He recalled his war-time experience when he bought Liberty bonds out of his soldier's pay. When he returned from France and had to sell his bonds to buy clothes and other civilian things, he got only $80 or a little more for his hundred dollar bonds "and later they were run up to $125. He said he did not want the people who hold our bonds now to have done to them what was done to him.

"He stated that most politicians would not ask for higher taxes prior to election but that he had vetoed a reduction in taxes before election and won anyway. If it had not been for that irresponsible reduction in taxes, he said, the Federal budget would have been in balance all these years. He stated that he wanted to levy all the taxes necessary to pay the cost of the defense effort, which he felt would be between 100 and 120 billion dollars over the next few years. He stated that he had just met with the Congressional leaders and asked for 16-1/2 billion dollars in taxes and that he expected to get this in two bites--a quick tax bill yielding about 10 billion and the other 6-1/2 billion to come after more careful study. He wanted us to understand that he is doing all he can on the tax front to combat inflation.

"The President gave each member of the Committee a copy of 'The Federal Budget in Brief'. He expressed the opinion that the budget had been pared to an irreducible minimum. He said that he had participated in the preparation of 16 budgets and felt he was competent to judge and understand them. Maybe something could be cut out but it would make a hole in the defense effort and that he would not do.

"The President said that he felt we had done a good job and wanted us to continue to do a good job in maintaining the financial structure of the country. He further stated that he had had a number of conferences with our Chairman but this was his first opportunity to meet and talk with the entire Committee. He made no mention of recent discussions with the Treasury.

"Chairman McCabe thanked the President for receiving us and indicated that we all share his concern for the maintenance of the Government credit. He stated that although the support of the Government bond market was something in the nature of an extra-curricular activity for the Federal Open Market Committee, it had performed this service for the past nine years or more and had done a very good job. He stated that the Committee had always carefully weighed its responsibilities to the Government and to the general economy as well and that these are statutory responsibilities which it could not assign, if it would.

"The President interjected that he was familiar with that but wanted the Committee to continue its good work during the defense period. He emphasized that he was speaking of the defense period only.

"Chairman McCabe referred to the fact that in the last few days the Government bond market had gone up a few thirty-seconds and then had come down a few thirty-seconds, which he considered to be a proper market operational technique. The President said he would not undertake to discuss details of that kind, that he was principally concerned with maintaining the confidence of the public in Government securities as one way of presenting a unified front against Communism. He did not indicate exactly the details of what he had in mind, but he reiterated that we should do everything possible to maintain confidence in the Government securities market. The Chairman outlined concisely some of the responsibilities with which we were charged, principally to promote stability in the economy by regulating the volume, cost and availability of money, keeping in mind at all times the best interests of the whole economy. The Chairman turned to the members of the Federal Open Market Committee and said the President could depend on everyone in the group to do what they could to protect the Government credit.

"Chairman McCabe stated that with a group of men such as those composing the Federal Open Market Committee (and with responsibilities in conjunction with those of the Treasury) there would, of course, be differences of opinion as to just how the best results could be obtained. The President nodded, indicating that he understood this. The Chairman suggested the following procedure--that we consult frequently with the Secretary of the Treasury giving him our views at all times and presenting our point of view strongly, and that by every means possible we try to reach an agreement. If this could not be accomplished, he (the Chairman) would like to discuss the matter with the President. The President said this was entirely satisfactory and closed the meeting on the same note as it was opened--namely, that he wanted us to do everything possible to maintain confidence in the credit of the Government and in the Government securities market and to support the President of the United States in achieving this end.

"The Chairman stated at the end of the meeting that he presumed that any statement concerning this meeting would be made by the President. The President said he would have no objection to our making a statement and thought that it might "be a good thing. The Chairman then asked him what would be the general nature of the statement and he said it can be said that we discussed the general emergency situation, the defense effort, budget and taxes, and that he had stressed the need for public confidence in the Government's credit. He said further that he would be talking to the press the next morning and that he would be prepared to answer any questions that might be raised. Since the President indicated that he would be discussing it with the press, the Chairman said he felt it would be best for us not to issue any statement to the press at this time. The President did not seem to be particularly concerned about whether or not a statement was issued. The press conference scheduled for the following morning was canceled because of General Eisenhower's appearance at the Capitol. The White House press secretary gave the press the following statement which appeared on the ticker about noontime:

"'Washn - A P - The Federal Reserve Board has pledged its support to President Truman to maintain the stability of Government securities as long as the emergency lasts.

"'White House press secretary Joseph Short announced this today, saying there have been reports of differences of opinion between the Treasury and the Federal Reserve Board.

"'This is to quiet those rumors - Short said.

"'Members of the Federal Reserve Board conferred with Mr. Truman yesterday - Secretary of the Treasury Snyder did not attend the meeting.'

"A little later the following statement appeared on the ticker:

"'Washn - A P - A Treasury spokesman said the White House announcement means the market for Government securities will be stabilized at present levels and that these levels will be maintained during the present emergency.'"

Chairman McCabe stated that as he understood it, the action taken by majority vote during the executive session was that the market on the long-term restricted bonds would be held at par and 21/32 until the next meeting of the Federal Open Market Committee, which was to be called for Tuesday, February 13, 1951.

Mr. Sproul said his understanding of the action was that the Committee would continue in effect until the meeting on February 13 the existing policy with respect to the purchase of long-term restricted bonds which would mean that, if the Treasury discontinued its support purchases of the long-term restricted bonds, the price might decline below par and 21/32.

In the ensuing discussion it was understood that the action taken in the executive session by majority vote was as stated by Mr. Sproul.

Chairman McCabe expressed strongly the view that until the Committee had had an opportunity to determine what its over-all policy was to be, it would be a mistake to allow the price of long-term restricted bonds to decline further.

Mr. Sproul suggested that the general direction to be issued to the executive committee be in the same form as that presently in effect but that the limitation in the first paragraph of the direction be reduced from $3 billion to $2 billion.

> Thereupon, upon motion duly made and seconded, the following direction to the executive committee was approved unanimously with the understanding that the limitation contained in the direction would include commitments for the System open market account.

> The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities,

> and letting maturities run off without replacement), as may be necessary, in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the aggregate amount of securities held in the account at the close of this date other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury shall not be increased or decreased by more than $2,000,000,000.
>
> The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held in the account at any one time shall not exceed $1,000,000,000.

It was also agreed that the understanding with respect to the rates at which short-term securities should be purchased and sold for the System account, reached at the meeting of the Committee on October 11, 1950, should continue in effect with the further understanding that in accordance with the letter sent to the Treasury following the meeting on October 30, 1950, the executive committee, for the time being, would not permit the rate on new securities maturing within one year to rise above 1-1/2 per cent.

With reference to the replacement of maturing Treasury bill holdings, it was agreed that the present understanding should continue unchanged, and that the executive committee should be guided by what would be required in the light of current conditions in the money market to carry out the general credit policy of the Federal Open Market Committee.

Thereupon the meeting adjourned.

Secretary