2. Engine of Inflation

IN NOVEMBER 1944 when it seemed that the war in Europe had been won, I found myself obsessed with one idea. I recalled that the economic disaster of the 1930's was largely due to the failure of our policies in the 1920's directly after the First World War. And it seemed to me that what would happen to us in the 1950's would largely be determined by the job we did in the transition period from war to peace in the last half of the 1940's. From the evidence available at the time this idea took root, it looked as though we were headed for long run trouble unless we altered the course of short run economic forces.

Given normal peacetime conditions (whose advent has since been delayed first by the cold war and then by the Korean war), the long-range problem for the economy was one of dealing with deflationary forces. The very magnitude of our production achievement in the war made that problem all the more acute. As of November 1944, though we had beforehand withdrawn for the armed services well over eleven million men and women in the most productive age groups, we at the same time increased the total output of the country seventy-five per cent above 1939 levels. We supplied goods and services in support of the war effort at a rate of about $85 billion dollars a year. At the same time the output for civilian use averaged about $110 billion. Per capita civilian consumption of food was well above the prewar level. We created many new industries or greatly expanded existing ones such as magnesium, synthetic rubber, aircraft, and shipbuilding. While fighting the greatest war in history, the country succeeded in raising the standard of

living for the population as a whole above the level of any peacetime year.

For both political and economic reasons we could never go back to the 1939 levels of production. Men and women who had a taste of full production and a rising standard of living (compared with the depression of the thirties) while fighting a global war would be more than reluctant to accept mass unemployment as a recurrent and normal condition of life. To go back to the 1939 levels of production would mean that 15 to 20 million workers in our postwar labor force would be without jobs. But if the 56 million workers in the country were to have jobs—this being the labor potential as of November 1944—then enough money in salaries and wages had to be spent to buy the output of 56 million workers. Otherwise a cumulative deflation and unemployment would develop and could be avoided only if the government stepped in and provided a sufficient volume of total expenditures. Thus the problem of the 1950's would be similar to that of the 1930's with the important exception that in the latter period the economy had undergone a drastic deflation and not only were large government deficits unavoidable, but it was desirable to replenish a contracted money supply. In the period after the Second World War the total volume of currency, bank deposits, and government securities, which were the equivalent of cash, would be more than adequate as a basis for the purchasing power needed to provide full employment.

With this in mind, in November 1944, in an address before the National Industrial Council meeting in New York, I said:

> A more direct approach than deficit financing has to be found in order to maintain necessary expenditures. To have the government underwrite employment through borrowing the unspent savings of the people and returning them to the income stream should be a last recourse. (Its net effect would be to increase an already existing abundant supply of money and credit.) A much more satisfactory approach would be to bring about the necessary increase in the flow

of expenditures by other means; for example, by an extension of the Social Security program and by appropriate tax policies that would induce more spending and reduce idle savings.

While the basic long-range problem was to avoid deflation by providing a flow of necessary purchasing power to those who would use it to increase their standard of living, the short-run problem as it appeared in November 1944 was clearly one of dealing with inflationary forces. I should be laboring the obvious to say that more recent developments have made this short-run problem extremely acute. But even in November 1944, all the elements were present for an eruption. We faced a tremendous backlog of demand for capital goods and consumer durable goods, continued shortages of certain food and clothing items, a vast backlog of foreign demand, billions of dollars in balances or credits foreigners held to back up their demands, and a huge volume of liquid assets in the hands of the American public to back up its demand. An idea of the magnitude of these assets can be gained by comparing them with the total at the end of the First World War. In 1920, currency and demand deposits amounted to less than $25 billion. At the end of 1944 they exceeded $110 billion. In 1920, government securities held principally by individuals and corporations amounted to less than $20 billion as compared with more than $80 billion in 1944. Liquid assets in the hands of individuals and business in 1944 were therefore in the aggregate of nearly $200 billion, as compared with $45 billion in 1920. Similarly, government debt, which was approximately $25 billion at the peak of the First World War, was nearly ten times as large and was still growing in 1944. Yet the relatively small volume of funds after the First World War produced one of the worst credit inflations and the consequent economic collapse of the early 1930's. Under these circumstances simple prudence indicated the imperative necessity of maintaining intact the wartime harness of controls until such time as industry had re-

sumed civilian production on a scale large enough to meet effective demand. Only in this way could a consumer be assured that he would not lose by postponing purchases and that the purchasing value of his savings would be protected. Without such assurance, he would try to convert his dollar into goods and thereby help to bid up the prices of the very things he wanted to buy.

When I saw President Roosevelt after the November elections, I undertook to state some of the foregoing to him. But I was appalled by his appearance and deeply saddened by his manner. He was haggard and drawn. His eyes lacked their familiar sparkle. He did not speak with his usual ease. He seemed to find some difficulty in his articulation. More often than not, his mind seemed to wander off into secret recesses, as if to escape from the pounding of the words it heard.

Following that November meeting with Roosevelt, I felt it would have been inhuman to harass him with my problem. I had never been restful to him in previous years. As these pages may indicate, I had continually ragged him to do what I felt should be done. I believe I held the President's respect for this tenacity of purpose, but it was not the sort of relationship that could bring comfort to an exhausted man. In his obviously desperate physical condition the very least I could do to help him was to take my arguments and goads to other quarters.

Throughout his Presidency I usually found myself in agreement with Roosevelt's social objectives, though I often disagreed with his ideas as to the way they could be achieved. But whether I agreed or disagreed, whether I had moderate, slight, or no influence whatsoever on his particular decisions, I always felt we were working on the same team. I sorely missed him when he was gone.

Of many conversations I had with him in his lifetime, one in particular returned to me when he was gone; I digress for a moment to reconstruct it. Nothing of surpassing public significance was said; yet in a sense it seemed to compress a good part

of Roosevelt's personality into a few sentences. The circumstance surrounding the conversation was this:

During a visit to Warm Springs in the fall of 1938, I found time to play a round of golf with Marvin McIntyre, and later, when the game was over, I happened to tell the President how pleased I was with the character of the golf course. Suddenly a hot wave of embarrassment rose within me even as I continued my enthusiastic remarks. I realized that I was speaking about golf to a man who was paralyzed. But a split second later my embarrassment gave way to astonishment when the President interrupted me to say:

"I've always had a great interest in golf. You know, I laid out this course at Warm Springs and supervised every detail of its construction. I can tell you the location of every green, trap, and hazard on the links. I tried to make it an interesting nine-hole golf course, considering the land that was available."

To prove his point, the President then proceeded to describe in detail every aspect of the course. He continued:

"I started to play golf when I was a very young man and was quite good at the game. Once while I was in school I made a bet that I could knock a golf ball at least four hundred yards. The other fellow said that was a ridiculous boast and figured he had easy pickings. Well, unfortunately for him he didn't specify the exact conditions under which I was to hit the ball. I, therefore, took the golf ball down to a lake that was frozen over. Naturally, when I hit the ball it skimmed over the ice for a distance beyond four hundred yards. I won my bet."

The President was not yet through with his reminiscences about golf. He went on to say:

"When I was an Assistant Secretary of the Navy, in 1915, I was a member of the Chevy Chase Country Club. Every so often I'd skip away from work to play a round. Well, you know that hole where you shoot up a hill and can't see the green? It's a blind hole. Well, one day out on the course, from that tee I hit a ball and it sliced to the right. I didn't want to lose it,

so I immediately ran up the hill to see where the ball was going to land. To my dismay, I saw it hit Count Johann von Bernstorff, the German Ambassador, right in the seat of his pants. He let out a Valkyrie war-whoop which brought his golf partner, Cissie Patterson, running to his side with a mouthful of soothing words.

"Naturally, I immediately ducked my head and ran down the slope, hoping I'd not been detected. I made for my tee and put a second golf ball on it. 'Say, what's the idea?' my partner said. 'You've got to play the first ball.'

" 'Sh!' I said, 'I'll tell you later. When I hit the ball, and we get up the hill, don't look either to right or left. Don't pay the slightest attention to whoever you see.'

"I hit the ball and deliberately hooked it to the left this time. Then I started out after it. But being partly Scotch, I was very much tempted to seek out the first ball I'd abandoned. However, I decided not to succumb to the temptation. When my partner and I came within sight of Count von Bernstorff and Cissie Patterson, we could tell that we were under suspicion because of what had happened to the Count.

"Later on, when the Count was kicked out of the United States because of his espionage activities, I came to regret that the injury to von Bernstorff was so trivial."

It was this conversation that I remembered with sudden clarity when it came time to appraise his career. So much for this digression.

From the time in November of 1944 when I saw the President's alarming condition, it was James Byrnes who heard my constant warning that we had no adequate fiscal and monetary policy laid out in advance to deal with the inflationary potential that might ravage the economy when the war ended. As the weeks passed and the rate of wartime expenditures continued to accelerate, and as the volume of money and other liquid assets in the hands of the public rose higher and higher, I lived in great concern lest the dam that held back the inflationary pres-

sure should give way and destroy the prospects for postwar economic stability.

In February 1945 I called the attention of Fred Vinson, then the Economic Stabilizer, to the degree of inflation that had taken place in capital values. Farm values had increased by more than 44 per cent over the 1935–9 averages, and in eight states had risen more than 60 per cent above prewar levels. Similarly, urban real-estate selling prices were up 33 to 50 per cent or more over the 1940 level. Likewise, in the stock market, prices were higher than at any time since the autumn of 1937 and were fully 80 per cent above the low point in the spring of 1942.

I told Vinson's Stabilization Board:

> Smart money is already going into capital assets for speculative purposes and to take advantage of a loophole in the tax structure. Blocked off by allocations, by rationing, and by price controls applying to scarce materials and goods, these liquid funds, including billions now invested in war bonds, could be used to produce a disastrous inflation of capital values that are not now subject to effective controls.

At this time I argued that a penalty rate on capital gains corresponding to the highest surtax rate was the most effective and simple over-all instrument to take the speculative fever out of the market for real estate, stocks, commodities, and other capital assets. Once that impulse was removed—once people did not "run from the dollar" to make speculative investments in goods—then the danger would be largely if not entirely met.

If, on the other hand, the penalty tax was not imposed, then it was clear that more and more billions that were or should have been invested in war bonds would be tempted into capital values. To the extent that this happened, it not only would undermine the government's financing operations, but would multiply inflationary forces that threatened at that time and in the future. More and more funds would then have to be raised through the banking system. That, in turn, would mean more

newly created money, adding fresh fuel to inflationary fires. This argument alone would be a compelling reason to impose the tax. But there were other stronger considerations. I expressed them at the close of my remarks before the Stabilization Board:

The so-called GI Bill of Rights is one of many assurances to returning veterans that they will be helped in buying a home, a farm. What becomes of such assurances if the prices of homes and farms are driven to prohibitively high levels because of a failure to close this gap in the tax laws? How can anyone defend a situation in which the bigger the speculator, the greater the advantage to him in escaping from high surtaxes through the loophole of the capital gains tax? What becomes of pledges to take the profiteering out of war when this invitation to make fortunes out of war conditions is held out to big speculators, businesses, as well as individuals? How can we hold the line on the labor front if we fail to put a stop to this flagrant war profiteering?

If this simple over-all action should subsequently turn out to be insufficient to curb rising prices of capital assets, then supplementary action to restrain the use of credit could be taken with justification now lacking. The defect in credit curbs alone is that they put second things first at a time when private credit expansion is not the dangerous factor, and they prevent regular, legitimate transactions, but fail entirely to reach the speculator operating on a cash basis. The penalty rate on capital gains would strike effectively at the speculative buyer without interference with legitimate transactions.

As in all other areas, nothing was done in this one to curb the inflationary forces that were at work.

With the end of the war in Europe, we were left with three fronts on which to expend our efforts. One was the Japanese war, calling for sizable expenditures but not, in my opinion, for a continuation of the huge expenditures made prior to the defeat of Germany. On the basis of the best statistics available, it was estimated that in the period between 1940 and the end of 1944 we had spent more dollars (based on existing exchange rates) than the combined expenditures of all our allies. In the first

three years of our active participation as a belligerent, the total expended by the United States was approximately $220 billion as compared with $147 billion by our allies.

Upon the defeat of Germany, it seemed to me that we could make a heavy cutback in this rate of spending on the military effort. To the extent to which that was possible we could strengthen two other fronts, the domestic economic one, and the peace front in Europe. That is, in so far as we curtailed military expenditures and allowed our economy to reconvert in part to peacetime production, we could curb some of the inflationary forces that menaced us. Moreover, by diverting military funds to the relief and rehabilitation of Europe and by making available goods to be bought by those funds, we could help nip in the bud the manifest intention of the Communists to exploit social and economic disorder in postwar Europe.

I expressed this view to President Truman on May 29, to Harold Smith on May 30, and to Harry Hopkins on May 31, as I had earlier expressed it in meetings with Generals Somervell and Clay. But the most memorable meeting of all came in the home of Senator Brien McMahon one evening in June. A number of congressional leaders were present, as was the then Under Secretary of War, Robert P. Patterson. I was pressed by Senator Scott Lucas—with no reluctance on my part—to appraise the inflationary dangers we faced.

Though it would have been presumptuous for me to tell the military how to fight the war against Japan, there were common-sense observations one could make about current military expenditures in relation to the problem of inflation. In support of my contention that there should be sharp cutbacks in the rate of military expenditures, I noted that, with Germany out of the picture and Japan our only enemy, we could fight a war of attrition against her instead of redeploying our forces in Europe for another amphibious assault in the Pacific. The Japanese Navy had been driven from the seas, and her aircraft from the skies. The Japanese home islands were under blockade. In peace-

time conditions they did not support themselves with either foodstuffs or major industrial items such as iron ore, oil, coal, or copper, but had to import all of these. Difficult as was the Japanese food and production problem in time of peace, it was doubly difficult under the existing conditions, when the home islands were being bombed like a rat in a trap. How could they escape surrender in a war of attrition?

This being the case—and I did not at this time know of the atomic bomb—we could leave it up to our Navy and Air Force to handle the home islands of Japan, and to the Russians to handle the Japanese forces on the mainland of Asia adjoining Russia. I expressed the view that if the home islands fell, the Japanese forces in Asia would lay down their arms; if they did not, they would be engaged by the Russians. Instead of this, we were making preparations for an amphibious assault on the home islands, as well as the continent of Asia, that would surely bring about great organized resistance by Japan's civil population and would result in the needless loss of thousands of American lives, and billions of treasure. If we diverted the whole of our energies to the Japanese war, we would leave ourselves in no position to deal with domestic inflation and with the establishment of peace in Europe. The rate of war expenditures was making the inflationary pressure more unbearable with each passing day, while social unrest in Europe was becoming increasingly serious. We could end by winning the war on all fronts and losing the peace on all fronts.

I could see no valid reason why, with all enemy fleets sunk or captured, our Navy proceeded at this time to place orders for ships that could not be built in from one to three years. I could see no reason why, with Germany out of the war, there was agitation in military circles for the adoption of a universal-service law (in contrast with selective service) or why the inductions of men into the forces continued at a rate that brought the size of our military establishment to its peak *after* V-E day. With Germany out of the war, the manpower represented by

the increase in the size of the Army could better have been used in civilian production so as to meet problems of inflation at home and that of reconstructing Europe.

In sum, the problem of winning the peace in Europe depended to a large degree on what we could do to maintain the sort of economic conditions at home that would serve our own and Europe's wants. Therefore, the most prudent course would be to make a cutback in military spending, and to let the Navy and Air Force carry on their war of attrition. The Japanese had no means of survival.

When I had finished this argument, all the men in the room turned to Under Secretary Patterson for a reply. It was a short one.

"The public," he said, "are demanding an all-out war and an immediate and all-out peace. There is no way of slowing down. We must continue to put up our maximum effort until the war ends. The public wants a complete demobilization, not a partial one such as you are suggesting."

I could argue the economic price, and the price paid in the fight for peace, because of this conception. There was no arguing the fact, however, that Patterson accurately summed up what the people wanted. Of course, people have not ceased to pay heavily for getting what they wanted.

In the period after V-J day, as in the war years, every economic group in the land wanted the benefits of inflation for itself, to be paid for by a different group. The farmer wanted a floor for his prices, but not a ceiling. The real-estate people, the building-materials people, wanted easy credit so that at inflated prices they could readily dispose of the houses and materials they had to sell. But they certainly resisted an excess-profits tax that would help the government recapture some of the profits that were thus made. Labor always wanted price controls, but vigorously resisted wage controls. The bankers wanted higher interest rates, but they did not want the federal banking agencies to have any other powers over the expansion of credit.

To accomplish a postwar adjustment with a minimum of inflation, two things should have been done. First, some reduction should have been made in the money supply in the hands of the public. Second, the harness of controls on the economy should have been retained until the full flow of peacetime production had been restored and some of the most urgent items of the deferred demand had been satisfied.

But we did neither of these things. True, an attempt was made to cut the money supply by reversing the wartime process of money-creation. For a brief period we created a government budgetary surplus. Money was withdrawn from the people by taxation and by the sale of savings and other bonds, and these funds were largely used to retire government debt held by the banks. From mid-1946 to mid-1948, Treasury budgetary surpluses had the effect of reducing the money supply in the hands of the public by eleven billion dollars. While this deflationary operation was going on, it was exceeded by a growth of private bank credit that was inflationary. All this followed the precipitate removal of wartime controls.

Controls over manpower were dropped and the Office of Price Administration removed ration restrictions on gasoline, fuel oil, processed foods, and heating stoves three days following the surrender of Japan. Three days later, by executive order, the President instructed federal agencies "to move as rapidly as possible without endangering the stability of the economy toward the removal of price, wage, production and other controls and toward the restoration of collective bargaining and the free market." This was one order that was carried out with zest.

On August 21 the War Production Board discontinued the "Controlled Materials Plan," which had become the cornerstone of war-production controls. The plan was a relatively simple device for dominating the industrial economy by giving the Board complete control over a few strategic commodities such as steel, copper, and aluminum. By the end of August, control and priority orders were revoked over most metal with

the exception of tin, lead, and antimony. Soon thereafter industrial-construction restrictions, allocations, and building permits were first eased and finally ended altogether. Simultaneously, the Office of Defense Transportation lifted almost all its controls over motor vehicles and railroads with the exception of facilities for military demobilization. Early in September a large portion of the controls over exports was lifted, and coastal and intercoastal shipping was resumed. On November 4, 1945 the production controls that still were in effect—for items such as textiles, clothing, leather, and certain scarce materials such as rubber, tin, lead, and various chemicals—were transferred to the Civilian Production Administration, and the War Production Board was eliminated. By the end of 1945 only sugar continued under rationing and price control.

While with one hand all these breaches were made in the wall holding back the tide of inflation, with a finger of the other hand President Truman tried to stem the flood. A few days after V-J day he instructed the Price Administrator to "take all necessary steps to assure that the cost of living and the general level of prices shall not rise." Price increases could be allowed only if they did not cause increases at later stages of production or distribution. Wage increases could be made without approval of the National War Labor Board, but only if such increases were not to be used to seek an increase in price ceilings.

All this was well intentioned. But the economic stabilization program based on these directives was doomed to failure, as I repeatedly argued both within the Administration and before congressional committees. For every part of the harness of controls was closely related to every other part and should be changed or removed only as adequate supplies developed. Since these direct controls were, or should have been, subordinate to fiscal and monetary policy, and since they dealt only with the effects of inflation while fiscal and monetary policies struck at causes, when a shortsighted fiscal policy was inaugurated in the late fall of 1945, it compounded the mistake of the premature

removal of direct controls. I refer to the precipitate removal of the excess-profits tax.

During the war years the excess-profits tax had been a major tool for curbing inflation. It had reduced the desire on the part of business for price increases, and on the part of labor for wage increases. It had helped hold down the deficit and the need to borrow. It had helped curb or remove profiteering in the war. These reasons for maintaining the tax in the war years applied with equal or even greater validity in the postwar years, and certainly so in the period of reconversion directly after V-J day.

At that time we still faced a heavily unbalanced budget. Every dollar of government expenditures not raised by taxes had to be borrowed. To the extent that banks were required to furnish these funds, new supplies of money would be added to the already enormous accumulations of liquid funds in the hands of the public as a result of war financing. Demands, both domestic and foreign, upon our economy would continue for an indefinite period to be greatly in excess of supply; thus profits to be made in the year or so immediately after the end of the war would be a direct result of war expenditures and thus just as much war profits as if they were derived while hostilities were still in progress.

With the precipitate removal of other controls, the most prudent course for curbing inflation would have been to defer tax reductions until such time as supply was more nearly in balance with demand and we had a greatly improved budgetary picture. It would have been wise to err on the side of too much rather than too little revenue. Taxes could always be reduced.

We had a clear obligation to protect government credit and the billions upon billions invested in government bonds and other savings. This could be done only by bringing about a balanced budget and preventing further bank-credit expansion as promptly as possible once the war was over.

In November 1944 I stated in my speech before the National Industrial Conference Board that if there were to be any tax

reductions they should apply first to those least able to pay taxes and not to those earning excess profits or in the higher-income groups. But this order of preference was ignored by those who advocated, immediately after the war, the repeal of excess-profits tax. Repeal helped those who could best support the tax load that was needed to bring the budget into balance, to end borrowing from the banks, and thereby curb any further growth in the volume of money and credit. By and large, the business and industrial firms that were required to pay the excess-profits tax had never been so well off. They had never had such vast accumulations of cash or its equivalent, never bigger earnings after taxes, and never such glowing prospects of profits to be made in the years directly ahead in filling the unprecedented backlog of demands from domestic as well as foreign sources.

The mere talk in 1945 of an outright repeal of the excess-profits tax had four adverse effects. It did much to boom the stock market, drawing into this vortex of speculation funds that the government should have received. It whetted the appetite of labor for bigger wage boosts, which were backed by strikes. It induced corporations that were subject to the excess-profits tax to hold up sales in the last quarter of 1945 in the expectation that their profits on accumulated inventories would be much greater in 1946 after the repeal of that tax. In other words, it invited inventory speculation in anticipation of large profits, which seemed sure to develop from rising prices and lower taxes.

The argument that business needed a special tax incentive to produce and to employ people at that time was inconsistent with the basic economic facts. The war demonstrated that if business had orders it would go ahead producing and furnishing employment notwithstanding high taxes. With intense demand for goods of every kind, capacity production would proceed even if there was an excess-profits tax. As for new enterprise, its main problem was to obtain material and labor in order to get under way in competition with established industry.

Not unless it was carried over as a permanent part of the tax structure at high rates could the excess-profits tax be considered a deterrent to new and small enterprises, since it usually takes years at best for them to make earnings that would be subject to such a tax. Moreover, the Tax Adjustment Act of 1945 provided for an exemption of twenty-five thousand dollars under the excess-profits tax. This was a decided boon to the smaller concern, though it meant little to the large and most profitable ones. Instead of benefiting from repeal of the excess-profits taxes, the smaller concern stood to lose the advantage of the exemption. On the other hand, as a Treasury analysis of the tax applications conclusively showed, the repeal of the tax would benefit the big industries.

The contention that repeal of the excess-profits tax would help provide employment and prevent deflation was as untenable as any of the other reasons advanced on behalf of repeal. Such unemployment as existed in 1945 was transitional in character. It was not at that time spreading into a cumulative deflation such as occurred after 1929. Nor could it take any such course in the short run so long as purchasing power and demand remained enormous. While it was true that long-range economic problems had a deflationary aspect, to have characterized the immediate outlook in 1945–6 as predominantly deflationary was a highly superficial judgment. To assure a rapid and permanent re-employment of service men and war workers, the first need was to prevent inflationary developments that would lead in the end to an ultimate breakdown and deflation.

Despite all the foregoing reasons for maintaining the tax, there were abundant indications immediately after V-J day that the Administration, under great pressure from the business community, was favorable to a repeal of the tax. The new Secretary of the Treasury, Fred M. Vinson, advocated this course of action and was joined in doing so by John W. Snyder, then the head of the War Mobilization and Reconversion program, and by Julius A. Krug, then the head of the War Production Board.

The argument for a repeal of the tax echoed the argument for a removal of all direct controls. It was said that the tax was a war measure and that the war was over; that business interests should be encouraged to convert promptly and should have every incentive to produce a maximum amount of the goods that were needed. Only in this way could inflationary developments be checked.

I strongly opposed the repeal of the tax at that time, and in a letter sent to Secretary Vinson on October 20, 1945 I tried to answer point-for-point the contentions of the advocates of repeal. I argued that if any tax reductions were made at that stage, they should benefit primarily those at the bottom of the income scale, not those individuals and corporations best able to pay taxes. Repeal of the excess-profits tax in particular, I said, not only favored the few and the financially strongest corporations, but would grant them these benefits, including refunds, at the government's expense when revenue was of critical importance; it set an example in pocketing what were in fact war profits, which made it difficult to argue that labor should be denied correspondingly large wage increases; and the effect was to invite the familiar wage-price upward spiral. In conclusion I argued:

> The underlying need at this stage is not to arrest a deflationary spiral and to put funds into the hands of people who will spend them or to offer special tax inducements to business to produce. The basic underlying need is to restore as rapidly as possible a budgetary situation which will maintain faith in the currency and preserve the buying power of the billions invested in government securities and other savings.

This plea was ignored. On the advice of those who guided him in these matters, President Truman in November 1945 requested Congress to repeal the excess-profits tax. Congress was to accommodate him in this matter. But, with the request for repeal, the wage-price spiral was spurred on to its postwar career.

While it was under way, I often wondered why Americans still clung to their war-bond savings even though a continuing inflation reduced the value of their purchasing power. At a loss for a better explanation, I could only attribute this action to the factor of memories carried over from the depression years. During those years people who had savings learned the enormous value of the dollar. On the other hand, people who were in debt learned how painful it was to pay off debts. Thus the disposition was to hang on to savings, though inflation silently devoured them even when they were kept snug in a safety vault.

I have said that the postwar wage-price spiral began with President Truman's request for a repeal of the excess-profits tax. The connecting link between these events can be simply stated. Along with almost all other groups, labor was restive over wartime restraints. The no-strike pledge and the "Little Steel" formula were not popular, but were endured so long as the war was on. With war's end, labor's bargaining position for increased wages was strengthened by the fact that the labor market was relatively tight in its supply, while at the same time the elimination of overtime work in many industries reduced take-home pay.

In the absence of the no-strike pledge and labor co-operation, the National War Labor Board could not function effectively, and no alternative plans had been prepared to meet the demands of labor for substantial wage increases. The resignation of William H. Davis as Director of the Office of Economic Stabilization in October 1945 marked the beginning of the end of an effective government wage policy. By the end of October the demand for substantial wage increases was given formal recognition by the President. In an address to the nation at that time he contended that industry as a whole could grant wage increases while "holding the line" on prices. An executive order issued at the end of October provided that wage increases could be used in justification for price adjustments in certain instances.

The Stabilization Administrator was given power to define additional classes where wage increases could be approved to correct maladjustments and inequities. Management, however, maintained that wage increases across the board could be granted only if prices were allowed to rise. The Labor Management Conference that convened on November 5, 1945 ended in failure fifteen days later, primarily because management, along with some segments of labor, contended that an over-all wage policy could not be formulated by such a conference.

Nor could labor be blamed for losing interest in the conference when it ran concurrently with the President's request to Congress that it repeal the excess-profits tax. With corporations given this extraordinary measure of relief from a burden that was not onerous, why should laborers bind themselves to no-strike pledges or to the Little Steel formula? The answer was that they refused to be bound. Though continued production was a main element in the fight against inflation, labor sought to adjust its position vis-à-vis the profits of management by ordering mass work stoppages in key industries.

The winter of 1945–6 had the character of one long strike. In his attempts to restore industrial peace, shattered in the first instance by a request for the repeal of the excess-profits tax, the President appointed fact-finding boards to hear the major disputes and to make recommendations for settling them. These recommendations had no force of law behind them and did not have to be accepted by the parties in dispute. In most instances the boards agreed that wage increases were necessary, and when the eighteen-per-cent pattern developed in February 1946 upon settlement of major strikes, effective wage controls were almost eliminated, and the National Wage Stabilization Board was terminated by executive order after a desultory existence for one more year.

With the excess-profits tax repealed, with wages uncontrolled, with rationing, allocations, and building permits ended, the Office of Price Administration faced an impossible job of main-

taining a price-stabilization program. The Administrator could fix prices, but goods were not available at the price fixed, and the policing and enforcing job became an impossible one. You could buy anything and everything on the gray and black markets. It was a period of fabulous, illegal profits with associated tax evasions. In the end the strongest support for the tattered semblance of price control came from the black-marketeers, just as the bootleggers were the strongest supporters of prohibition. The taint of the black-marketeer was widespread, smearing him as well as otherwise law-abiding citizens who "wanted something special."

Even though an effort was made to continue price control for another year, the President by executive order officially ended it on November 9, 1946, after the various pressure groups, particularly in the agricultural field, had brought about decontrols of meat and dairy products shortly before the November elections. All that remained under any control after November was rent, rice, and sugar. By this time the increase in prices that had taken place since V-J day exceeded in many cases the increase that had taken place from 1940 up to V-J day.

I had tried to call attention to this sort of development several years before in testimony before the Senate Banking and Currency Committee. On March 24, 1944 I said:

> Inflations seldom get out of hand during wartime, but the danger carries over after peace comes and a war-weary people, tired of wartime controls and restraints, are eager to throw them off. This is just the time when it may be fatal to relax prematurely the controls of war-engendered inflationary forces.

When all controls were removed, the field that reflected the greatest amount of inflation was the construction industry, and particularly its housing branch. This was due primarily to the stimulation that the government gave to housing through its veterans and FHA programs. In the case of the veteran, a government-guaranteed mortgage was provided on excessively easy

terms. No down payment was required. The principal was payable over a period of thirty years, with interest at four per cent. The other program provided new and excessively easy terms of payment under the FHA insurance plan for rental housing as well as individual housing ownership.

Moreover, in order to create a universal demand for the veterans' guaranteed mortgage as well as the insured mortgage, the government through the Federal National Mortgage Associations, a subsidiary of the RFC, became a large purchaser of these mortgages. The net effect of the government's housing programs made it the most inflationary factor in the economy. And on November 25, 1947, at a hearing of the Joint Committee on the Economic Report held during the special session of Congress called to deal with the inflation problem, I stated what I felt would be the inevitable consequence of the policies being pursued by the government.

I agreed that if the easy-credit situation was producing a substantial additional volume of housing at supportable values in the long run, it would be justified. But, because of limitations of labor and materials, it produced, instead, a dangerously inflated market, which could not be sustained for both new and old houses. "Good low-cost housing cannot be built with high-cost materials and high-cost labor. Neither government nor private industry can produce this miracle." I further argued that from the long-range standpoint it was vitally important to prevent inflation in the housing field from getting any worse, since the greater the inflation, the more severe would be the aftermath of defaults, foreclosures, liquidations, and bankruptcy. "It is," I said, "easy to get into debt, but the easier it is to get in, the harder it is to get out. That applies to all of us, including war veterans."

The pattern of mortgage growth accelerated in the years after 1947. Exclusive of large-scale housing projects, the volume of mortgage financing on homes of from one- to four-family units averaged approximately $5 billion a year and had grown from

$19 billion on V-J day to approximately $40 billion at the beginning of 1950, or more than double in four years. The growth during 1950 up to the time of this writing has been even greater than the rate prevailing heretofore, and this despite the increased shortages of building materials and labor. This has increased costs for housing to a point where they now exceed by one hundred per cent the costs in 1940.

The only way a large part of the present outstanding private housing and consumer debt can be paid is through an expansion of the government debt. As a result of the Korean war it now looks as though this will occur. With a new and huge armament program under way, the public will get more money than it will be permitted to spend. And accordingly, it may apply the excess on debts, as was done during the Second World War, when private, individual, and farm debts substantially decreased as the government debt increased. Yet it is a sorry commentary on the way we manage things that it has taken a Communist threat to save us (in the short run) from the hard economic consequences of a deflationary credit contraction resulting from the unsound housing-credit policies pursued by the government since V-J day.

For all the costly errors committed by the government in the way it dealt with fiscal and direct controls, the inflation after V-J day might have been moderated by appropriate action taken to restrain unwarranted expansions of bank credit. Prior to the war the ability of banks to expand credit was limited by the existing supply of bank reserves, which was largely subject to Federal Reserve control. Except during the period of large gold inflow, which brought an excessive volume of reserves, the available supply of bank reserves was determined principally by the volume of member-bank borrowings from the Reserve banks or by Federal Reserve purchases and sales of government securities in the open market. These open-market operations were definitely regulated in amount so as to provide the supply of reserves required by the economy. Variations in prices and yields on

government securities were an incidental result of these policies.

But the method of financing the Second World War changed all this. Bank portfolios bulging with government securities were immunized against the effects intended by the Reserve System when it used its traditional methods of monetary control. That is, when a bank wanted more reserves on the basis of which it could expand the volume of its loans, it merely sold some of these government securities to the Reserve banks. This created reserves on which at least a sixfold expansion of credit could take place in the banking system. The potential inflationary expansion of the money supply was thus enormous.

Traditional actions to restrain the inflationary potential by changing the discount-rate policy were largely irrelevant, since banks had little or no occasion to borrow funds to maintain reserve positions so long as they could sell government securities for this purpose. Or, again, a moderate rise in yields on government securities would not prevent and would only slightly restrain banks from selling securities in order to make loans. On the other hand, an increase in rates large enough to exercise effective restraint on banks may have to be too great or too abrupt to be consistent with the maintenance of stable conditions in the government-securities market.

Theoretically, the Federal Reserve could stop the expansion of bank credit by denying reserves to the banking system. It could do this by refusing to purchase government securities in the market. The result would be that the prices and hence the rates on government securities would be determined by the demand and supply in a free market. But if this were done, considering the size of the public debt and the constant and huge refunding operations, the Treasury would be confronted with an impossible debt-management problem. It could not tell from day to day on what terms it could do its refunding or sell new securities. It would be entirely at the mercy of uncontrolled factors in the market, if, indeed, conditions did not become so con-

fused and chaotic as to demoralize completely its refunding operations.

The difficulties that arose between the Treasury and the Federal Reserve were not due to a clash of personalities. They were due to a conflict of responsibilities. The Treasury's primary job is to finance the government at the lowest cost at which it can induce the public to buy and hold government securities over a long period. As an independent agency responsible to Congress, the Federal Reserve has the job of regulating money and credit in such a manner as to help maintain economic stability. Theoretically there should be no clash between these two objectives, but one did arise after the war over the continuance of the cheap-money policy of the wartime period of heavy deficit financing. This conflict has continued up to the present time and has intensified since the outbreak of the Korean war despite the existence of budgetary surpluses and increasing inflationary pressures. Throughout the whole of this period, the Treasury Department under Secretaries Morgenthau, Vinson, and Snyder took a consistent line in opposition to the Board of Governors of the Federal Reserve System both in my own day as Chairman and in the days of my successor, Thomas B. McCabe. The highlights that follow of the relationships in the past five years between the Treasury and the Reserve Board show that this is the case.

With the end of the war in sight, I felt that the fixed pattern of rates used to finance our huge war expenditures was no longer justified; that the Federal Reserve should adopt monetary and credit policies appropriate to postwar conditions in the economy rather than policies, which the Treasury desired, that were based solely on the cost of carrying the public debt.

More specifically I felt that the rate on Treasury short-term securities should be allowed to rise instead of being held or pegged at the exceedingly low wartime levels by Federal Reserve support. This policy would reduce the artificially wide spread between the rates on the short-term and the long-term

securities, which spread induced the market to sell the shortest-term securities and buy the longer-term securities, thus forcing the rates of these securities down and their prices up. The raising of the short-term rate would bring down the prices and put up the rate on the long-term securities; it would make government securities more attractive to nonbank investors as well as to banks; it would reduce the amount of government securities which the Federal Reserve System would be required to buy in support of the market and thus avoid the very inflationary effects of putting Federal Reserve funds into the market.

But the suggestion of change stirred up a hornets' nest of opposition in Treasury circles. An early example of this occurred when Fred Vinson was the Secretary of the Treasury, though the genesis of the conflict dated back to the days of Henry Morgenthau. Indeed, it was the continued domination of Treasury policy by a Morgenthau staff, with its chronic bias for cheap money in all seasons, that lay at the source of this and many other difficulties.

The instance involved was a trivial one. For that reason alone the sharp response it brought from Treasury circles speaks all the more of the frame of mind that prevailed there. What was involved was a suggestion that the Reserve banks discontinue the preferential discount rate of one-half per cent on loans secured by Treasury bills and certificates. This is less complicated than it sounds. The rate was established at all Reserve banks in October 1942 at a time when banks were being called on to do an increasing amount of war financing by the particular means of buying and holding Treasury bills and certificates. The preferential rate was part of the inducement offered the banks to get them to do this.

In the postwar years the reasons for keeping the rate no longer existed, since the problem was to retard the growth of bank holdings of government securities. In fact, the elimination of the rate was overdue in 1945. The longer it was kept, the more it tended to become fixed into the System. Among other

things, it would result in further speculation. Since banks could borrow from the Federal Reserve at one-half per cent on loans secured by Treasury bills, they could use the funds to buy certificates whose yield gave them profits in excess of the costs of funds they borrowed; and also they could buy long-term securities that brought them still higher profits.

All this was expressed in a letter the Board wrote Secretary Morgenthau on July 9, 1945. But he had no chance to answer it. Soon thereafter Vinson replaced him as Secretary of the Treasury. The Treasury staff remained the same, however, and one can assume that Vinson's reply was the same as the one Morgenthau might have made had he stayed long enough to sign his name at the bottom of the staff-prepared letter. Vinson replied on July 27 that the action proposed, "particularly, if it occurred at this juncture, might be interpreted by the market as an indication that the Government had abandoned its low-interest rate policy and was veering in the direction of higher rates."

The preferential rate was retained for the time being.

When another attempt was made at the close of the year to get the rate discontinued, Secretary Vinson informed me that the proposed action would increase the already large interest charge on the public debt. This was the dead-end position we were to reach in many other discussions. My files contain a memorandum dated January 31, 1946, for instance, reporting the results of a conference I attended with Secretary Vinson and four of his staff together with Allan Sproul, president of the Federal Reserve Bank of New York, and Dr. Woodlief Thomas, the then head of the Board's Research Division. The memorandum read in part:

> I said to the Secretary that it looked as if the System and the Treasury were at an impasse; that the Board was an agent of Congress with statutory responsibilities and that while the authority that the System had with which to meet [the inflationary situation] was not given at a time when the Government debt had reached

$275 billion they were the only powers that the System had and that they could be exercised for the purpose of meeting the inflationary conditions to some extent. I said that we're not proposing by this action to put interest rates up or increase the cost of financing to the Treasury even though the inflationary conditions that exist and the amount of money that was being created by further monetizing of the public debt indicated that under the statute, that is the action that the System should take.

The one alternative is to let things go with a further drop in interest rates and further monetization of the public debt with the Federal Reserve having no control whatever. The other alternative is for the Federal Reserve to exercise such control as it has by increasing interest rates and the cost of carrying the public debt as well as the earnings of banks, both of which are undesirable.

Secretary Vinson disagreed completely with our position.

The memorandum in which all this was recorded noted that "we have a very difficult problem ahead of us." The Secretary of the Treasury implied that we were proposing to stage a sitdown strike in refusing to carry out Treasury policy. On the other hand, it was clear that if we carried out Treasury policy we would default on the obligations Congress imposed on the Reserve System in the field of money and credit.

The one issue regarding preferential discount rates was resolved by the action of the Reserve banks themselves. All twelve of them recommended that the rates be discontinued. The matter was referred to the Board of Governors for veto or approval. Though we were aware of the Treasury's opposition, we could not honestly veto a proposal that we fully believed was in the public interest. Accordingly, in April 1946 the Board of Governors approved the stand of the Reserve banks, and the rate was ended. From the outset this clearly was a matter fully within the statutory discretion of the Board. It was a step that could be taken without impinging on the cost of Treasury financing. It was all the more surprising, therefore, that we encountered such strong resistance to it for almost a year.

As I now look back over this period when I was Chairman of the Board of Governors, I regret that the Federal Reserve did not take a more independent position despite Treasury resistance. There was no justification for our continued support of the Treasury's wartime cheap-money policy. The government had developed surpluses in place of deficits and therefore was retiring some of the outstanding public debt instead of increasing it. But while the public debt was being reduced, bank credit was expanding to finance private deficits. This added to the already swollen money supply at a time when goods and services were in short supply. The net effect was a further increase in inflationary pressures.

However, the Reserve Board's position vis-à-vis Treasury policies did materially improve at the beginning of 1947 when Lee Wiggins became Under Secretary of the Treasury and was given responsibility under the Secretary for the management of the public debt. The Treasury staff did not shape Wiggins's opinions; he was well able to shape his own. He had an unusual understanding of the problems he faced, and with it the courage to recommend programs.

During the period when he was Under Secretary, some changes in the right direction were made in the management of the public debt. When the ⅜-per-cent buying rate on Treasury bills was eliminated and the rate allowed to reflect the free market, bills rose in yield to a point where they were very close to the yield on certificates. Certificates in turn were allowed to rise from ⅞ to 1¼ per cent.

These changes, so far as they went, accomplished the desired purposes. As was anticipated, they brought down the price of long-term securities and increased their rate and, largely stopped the practice of selling the short-term securities and buying the longer term securities. But though it was desirable to let the short-term rate rise to the point of bringing the long-term 2½ securities down to par, this action by itself could not stop bank-credit expansion at that time. The expansion continued una-

bated and pressed the Reserve Board into choosing a course of action from among three hard and disagreeable alternatives.

First, by its support policies at fixed prices, the System could continue to put reserve funds into the market at the will of the sellers of government securities. But this action monetized the public debt, which increased reserves in the banking system and thereby greatly added to the inflationary pressures.

Second, it could reduce its support for government securities and operate only to maintain an orderly market; one in which securities would move more freely as they found their natural level. This would bring down below par the price of the long-term 2½-per-cent securities. But owing to the huge size of the public debt, the large amount of current refunding, and the strong opposition of the Treasury, at the time of which I am speaking the Federal Reserve did not recommend this policy.

Third, we could point out to Congress that the System needed new powers as a partial substitute for those it had but could not use under conditions that required it to support the Treasury's requirements.

As to this last alternative, the question of what supplementary powers the Reserve System would need had been under study by the Board of Governors since 1945. In the *Annual Report* to Congress for that year we suggested that the problem we faced could be met in one of three ways. They were, first, to limit bank holdings of government bonds; second, to increase the regular reserve requirement; and third, to hold short-term government securities or cash under a special reserve requirement.

In the *Annual Report* of 1946 the Board once again called the attention of Congress to the existing inflationary dangers and the inadequate power of the System to deal with them. But no specific plan was proposed at this time because we could not get either Administration support or congressional consideration for adequate legislation. In the fall of 1947, however, the inflationary pressures became so great, and the public clamor for action grew to such intensity, that a special session

of Congress was called by President Truman. It was at this time that the Board, under circumstances to be related in a moment, was at last given a chance to present a specific plan to deal with the question of restraining bank credit.

What we proposed was the special-reserves plan first mentioned in the *Annual Report* for 1945. As we conceived of it, banks covered by the proposal would be required (in addition to their regular reserves) to hold a special reserve consisting of obligations of the United States in the form of Treasury bills, certificates, and notes or (at their option) cash or its equivalent. The special-reserve requirement would apply to both demand and time deposits and would be subject to a maximum limit fixed by statute.

The requirement would apply to all banks receiving demand deposits, including member banks of the Federal Reserve System and nonmember banks—insured and uninsured. It would not apply, however, to banks doing exclusively a savings business. The power to impose and to vary the special-reserve requirements would be vested in the Federal Open Market Committee and would be limited by law to a period of three years. The requirement would be introduced gradually as credit conditions warranted.

If approved by Congress, the plan, we believed, offered a workable means by which the System could meet a double need: to support government securities and at the same time to restrain bank-credit expansion. Under the plan it would be possible to bring about at least a partial separation between government financing and private financing. In other words, the low rates from government financing would not determine the rates on all other types of financing. The low buying rate by the Federal Reserve for Treasury bills and certificates could be maintained without nullifying the effect on private lending of a substantial increase in the discount rate of the Federal Reserve banks. The plan would not lock up funds in the Reserve System upon which bankers would get no returns, as would be done if

authority was given for a further increase in reserve requirements. But it would lock up bank funds in short-term government securities, upon which the banks would get some returns.

Banking leaders who had a chance to study the features of the proposed special-reserve plan and had arrived at opinions adverse to its adoption argued their opposition along two lines. On the one hand they affirmed that the plan was impractical, socialistic, and unnecessarily drastic. On the other hand they asserted that the plan was not strong enough to accomplish its expressed objectives. The contrast between these two lines of argument was striking. They could not both be correct: the plan could not be too drastic and at the same time be altogether inadequate.

Those who maintained that the proposed requirement was unnecessary argued that the banks themselves had a vital interest in the conservative extension of credit and would prevent excess credit expansion as a matter of ordinary banking prudence. The banks, however, were confronted by a situation in which they could readily meet unlimited private credit demands at a time when such demands were vigorously sustained by inflation while those same demands were contributing to inflation. They were both cause and effect. The banks were not in a position to refuse legitimate, safe credit demands of individual customers on current loans when, taken separately, they appeared to represent legitimate credit needs. But in accommodating these credit demands freely, the banking system expanded bank deposits and added to the money supply.

The opposition of banking leaders to the use of measures that could check bank-credit inflation was unreasonable. They seemed to forget that in order to assist in war financing the government provided the banking system with additional reserves, which enabled the banks to buy government securities; that this created new deposits in the banks; and that banks also had the benefit of interest received on the government securities they held and would continue to hold for an indefinite period.

Assent to a temporary limitation on the further use of these funds was not too much to ask of them.

Despite strong objections from the bankers, I had every reason to expect equally strong support for the special-reserve plan from the Administration. My hope was based on the fact that in calling the Congress into special session President Truman had presented it with a ten-point inflation-control program, of which the restraint of consumer credit and the restraint of bank credit were the first two items.

Beforehand, while this program was being drafted, Clark M. Clifford, who was responsible for bringing the loose ends together for the President, called me and asked whether the Federal Reserve Board could suggest plans to deal with these two matters. In response to this invitation, and on behalf of the Board, I presented to him the special-reserve proposal for banks we had worked out, as well as another arrangement designed to restrain consumer credit. Thereafter the Board was asked to prepare a short statement covering our legislative recommendations for use in the President's message to the special session. Both the plans and the covering statement were approved by Clark Clifford two or three days before the President's message was sent to Congress. Secretary Snyder, in the meantime, had been presented with drafts of our work as it progressed.

The Board's statement read in part:

> Under prevailing conditions of employment and production, with the continued shortage of labor and materials, an increase in the aggregate outstanding volume of credit extended to individuals or to business would increase demand for goods and services without increasing total production. For this reason, I recommend two measures at this time which would help to restrain extension of credit beyond what is necessary to maintain the highest possible production.

Here there followed a reference to the restraint of consumer credit. The balance and the heart of the statement continued:

> As a more basic means of restricting excessive growth of bank credit, I recommend that Congress give to the Open Market Committee of the Federal Reserve System a temporary authority under which all banks engaged in receiving and paying out demand deposits may be required to hold in addition to present required reserves, some specific proportion of their deposits in the form of cash and balances with the Federal Reserve banks or other banks or in Treasury bills, certificates, or notes. At present the banking system has access, without effective limitation, to reserves upon which a multiple expansion of bank credit can be built. The proposed measure would serve to retard expansion of bank credit beyond the requirements of full and sustained production.

To my great surprise, when the President's message was read in Congress, it stated the need to restrain the creation of inflationary bank credit, but there was no mention of any special-reserves plan. The President's message instead merely said:

> One way to reduce monetary pressure is by reducing the excessive use of credit. At a time when the economy is already producing at capacity, a further expansion of credit simply gives people more dollars to use in bidding up the price of goods.

This indication of a goal to be reached without a specific way of reaching it led me to ask who had cut out the Board's plan. I was told by Clark Clifford that Secretary Snyder was responsible for the cut. I met with Snyder and John Steelman soon afterward and suggested that if the Administration didn't want to support what the Board proposed, then it should present an alternative program that could restrain bank credit in line with the President's message. But I was told that the Administration had no program to propose. Secretary Snyder correctly insisted that the field of money and credit was the primary responsibility of the Reserve Board and that I should speak for the Board and not for the Administration when the President's inflation-control program was considered by Congress. The Secretary assured me that he would support the con-

sumer credit proposals made by the Board, and though he would not support our recommendation for the restraint of bank credit, he would raise no objections to it. Congress would have to determine the merits of our case.

The Joint Committee on the Economic Report, then under the chairmanship of Senator Taft, was the first congressional body to hold hearings on the President's message. Since items one and two dealt with curbs on consumer and bank credit, I was called as the opening witness. Had I been in any way sensitive to political currents, I suppose I would have softened my words. But speaking on behalf of an independent agency and with no political ax to grind, it seemed appropriate to speak the truth as I understood it. Consequently, in detailing the causes of the inflation I cut at Democrats for removing the harness of controls, and at Democrats and Republicans alike for reducing taxes and failing to create large budgetary surpluses. I then outlined the proposal for a special reserve, stressing at the same time "that the need for action on the monetary and credit front would be reduced to the extent that needed action [was] taken on the far more important front of fiscal policy."

The whole of this testimony was given wide circulation in the press and won a warm compliment from Senator Taft. This came as a pleasant surprise, as indeed did Taft's whole attitude throughout the committee hearing. He seemed to feel there was some merit in the special-reserve concept. Accordingly, when various bankers appeared before the committee to testify against the plan, they ran into buzz-saw questioning, for which the Senator is celebrated. The bankers offered no substitute plan to curb bank credit. They contended publicly that the existing powers of the Board were more than adequate for the needs, even though they privately knew those powers could not be used by the System so long as it was required to support the government securities market at existing prices.

In addition to a second appearance before the Taft Committee, I had a chance to elaborate on the Board's proposals in

testimony before the Banking and Currency Committees of the House and Senate. In the meantime, however, Secretary Snyder appeared before the Taft committee in connection with another part of the President's program. When asked what he thought of the special-reserves plan I had proposed, he merely said, in what appeared to be an offhand comment, that he didn't think it would work; but he offered no substitute and gave no reasons for his conclusion.

This at once produced news stories of this order:

SNYDER DISAGREES WITH ECCLES ON RESERVES. SNYDER, ECCLES SPLIT ON BANK CREDIT CONTROLS. TREASURY HEAD AGAINST GIVING BLANKET POWER TO RAISE RESERVE REQUIREMENTS.

The press made it appear that Snyder had lined up with the bankers, who not only were opposed to the proposed curbs on bank credit expansion, but also opposed consumer credit controls.

With formidable opposition from the bankers on the one side, and the lack of support from the Administration on the other, Congress did not give the Board the power to authorize a special reserve, nor, for that matter, did it approve the restraint of consumer credit. I am not implying that we would have been granted power to impose a special reserve had the Secretary of the Treasury actively supported our request, or had he said nothing. Nor am I implying that there was anything invidious in his opposition to our program. Even my good and respected friend Allan Sproul, the president of the New York Federal Reserve Bank, appeared before the Taft committee and testified against the Board's program. Sproul offered no alternative course except to let short-term security prices decline and to let rates rise to the point where substantial support was required to maintain the long-term 2½-per-cent bonds at par. I also favored this course, but felt the reserve plan too was needed.

Nevertheless, while Sproul legitimately reflected the opposition of the bankers in his district to the special-reserve plan, I had earnestly hoped Snyder would support it. In the absence of anything better, it was the only way the Reserve Board could on the one hand serve the Treasury's need for a stable market for government securities at existing levels, and at the same time curb the inflationary expansion of bank credit called for in point two of the President's message.

Despite our failure at the special session of Congress in November 1947 to get the President's direct support for our efforts to carry out point two of his program, we did get unexpected support from him when the President's Economic Report for 1947 was sent to Congress in the first part of January 1948.

The report stated that, in view of their central relation to the control of inflation, current proposals for credit control, "especially those which have been presented by the Board of Governors of the Federal Reserve System for the increase of bank reserve requirements, should be given close study by the Congress, and legislation should be enacted of a sufficiently comprehensive character to make available all the powers that may be needed."

It was not until April 1948, however, that the Joint Committee on the Economic Report began its hearings on the substance of what had been sent to it by the President. In the meantime my term as Chairman of the Board of Governors had expired, and the President chose not to redesignate me to that post.

This at least caused a momentary diversion in my thinking and planning, and it will require a like diversion in this narrative.