4. Dilemma

Thomas B. McCabe, who was to succeed me as Chairman of the Board of Governors, had not yet been confirmed as a governor in April 1948 when the joint committee on the Economic Report began to hold its hearings on the report sent to it by the President toward the first of the year. Under these circumstances I continued to serve as Chairman pro tem and in that capacity was called before the joint committee on April 13 to testify on general economic conditions.

In all other appearances before congressional committees, stretching over a period of fourteen years, when I stated the Board's need for legislation to carry out its responsibilities, it was often said the request was based on my desire for more personal authority over the nation's banking system. I believe, however, that the April hearing before the joint committee at last repudiated that charge. The hearing came at a time when my personal status was on the wane. And yet, as the records of the testimony show, the arguments I presented on behalf of the Board as Chairman pro tem were not modified in the slightest degree.

These arguments, like the others that preceded them, fell on deaf ears. Inflationary pressures continued with increasing severity throughout the months that followed. By midsummer, they had become so acute that the President called another special session for the sole purpose of checking them. The impression created by the President's dramatic action was that he really meant to propose an inflation-control program that would be effective.

The proposals he did make were completely inadequate to meet the economic needs of the hour. They were attacked or defended, however, according to the current political needs—the hour being the eve of the Presidential campaign. Since the Republicans controlled both the House and the Senate Banking and Currency Committee that considered the President's program, it was not unnatural that some Republicans hoped I would serve their cause out of sheer pique because I had not been reappointed Chairman of the Board of Governors. Thus, though I could no longer speak as chairman of that Board, I was still called as a witness before these committees.

It is my recollection that I proved something of a disappointment to my Republican friends and a source of no pleasure to my Democratic friends. In this last connection, I have been told that when ways of getting Congress to pass the inflation-control program were being discussed at this time at the White House, a party to the discussion observed acidly that "the first thing we have to do is to control Eccles." There was justice to this comment. Having analyzed the President's program, I proceeded to tell the House Committee:

> The program taken as a whole seems to me to be more of a political program than an economic one, because there is in the program action called for which would be very inflationary.
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> I do not believe it practical to put back a complete harness of wartime inflationary controls, and I do not believe that to put back some and leave off others would do the job. I do believe that it is too late to avoid a serious deflationary adjustment at some point. The disequilibrium and the distortions have already been created. I do believe that the inflation can go further if nothing is done and a budgetary deficit develops.
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> I do believe it essential that credit controls of sufficiently broad power and authority, both in the consumer-credit and in the bank-reserves field, be made available. That can be, at the moment, the most useful, the most practical, and the most effective.
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> I do believe that everything within the power of the Administration and the Congress should be done to maintain a budgetary surplus.

I do believe that the federal government should do everything within its power to encourage the states to postpone every expenditure that it is possible to postpone, and set an example to the states by doing likewise.

I do believe that the federal government should not, for what seem to me political reasons, encourage a housing program in excess of the amount of labor and materials available, and encourage further inflation thereby.

I do believe that the federal government should do everything within its power to bring down food prices by encouraging more and not less production.

I do believe that we should—and I may sound naïve in this regard —adjourn political considerations, and I say that for both parties, and consider honestly and openly the economic facts of life.

In the 1948 campaign President Truman successfully pinned responsibility for the nation's economic troubles on the do-nothing 80th Congress. And yet a rereading of the record, part of which I have tried to present in the foregoing pages, suggests that the 79th Congress and the Administration itself were possibly more implicated in the events that led us to the serious postwar inflation which commenced immediately after V-J day.

There is but one postscript to be added to all this, and it is a final comment on Treasury and Reserve System relationships. In the winter of 1949 a subcommittee of the Joint Committee on the Economic Report met under the able chairmanship of Senator Paul H. Douglas to consider certain aspects of fiscal, monetary, and credit policies. I was invited unexpectedly to state my views before this committee. At one point Senator Douglas asked me whether it would serve a useful purpose if Congress were to instruct the Treasury on policies to be followed in debt management where they were dependent upon the monetary policies of the Federal Reserve System. He also asked whether I could suggest some operating standards to be given the Treasury by Congress with reference to relations between the Treasury and the Federal Reserve.

With the permission of Senator Douglas, I replied to these questions by letter on December 1, 1949, having prepared the text without consulting my colleagues on the Board or the staff. I had no desire to embarrass them at a time when the Chairman of the Board, Thomas B. McCabe, was also testifying before the Douglas committee. What I wrote at that time I now present in major detail as a summary of the unhappy and yet natural complications in Treasury and Reserve System relations over the years; complications that have their origins in the growth of the public debt.

The major portions of the letter read:

Decisions regarding management of the public debt set the framework within which monetary and credit action can be taken. As the size of the debt grew through the period of deficit finance in the 'thirties and particularly over the war period, Treasury needs came to overshadow and finally to dominate completely Federal Reserve monetary and credit policy. When the Treasury announces the issue of securities at a very low rate pattern during a period of credit expansion, as it did last Wednesday, the Federal Reserve is forced to defend these terms unless the System is prepared to let the financing fail, which it could not very well do. To maintain a very low rate pattern when there is a strong demand for credit, the System cannot avoid supplying Federal Reserve Credit at the will of the market.

Under these conditions it can hardly be said that the Federal Reserve System retains any effective influence in its own right over the supply of money in the country or over the availability and cost of credit, although these are the major duties for which the System has statutory responsibility. Nor can it be said that the discount rate and open market operations of the System are determined by Federal Reserve authorities, except in form. They are predetermined by debt-management decisions made by the Treasury. This will be true as long as the System is not in a position to pursue an independent policy but must support in the market any program of financing adopted by the Treasury even though the program may be inconsistent with the monetary and credit policies the System considers appropriate in the public interest.

With respect to the problem of how future monetary and credit policies are to be established, it seems to me Congress must choose from the following three general alternatives if the present dilemma confronting the Federal Reserve System is to be resolved:

(1) Congress can permit the present arrangement to continue. The Treasury would control in effect the open market and other credit policy as it does now by establishing such rates and terms on its securities as it pleases, with the requirement that the Federal Reserve support them. It should be recognized that under this course, limitations over the volume of bank credit available both to private and public borrowers, and accordingly limitation over the total volume of money in the country, would be largely given up. Such credit and monetary restraint as might be required from time to time to promote economic stability would be entirely dependent upon the willingness of the Treasury to finance at higher interest rates, and in the past the Treasury has been resistant to doing this. If this alternative is followed, which is the present arrangement, Congress should recognize that the responsibilities for monetary and credit policies are with the Treasury and not with the Federal Reserve System and that the principal purpose of the Federal Reserve System is then to supply additional bank reserves on the demand of any holder of Government securities at rates of interest in effect established by the Treasury.

(2) The Congress could provide the Federal Reserve System with a partial substitute for the open market and discount powers which debt management decisions of the Treasury have rendered and can continue to render largely useless for purposes of credit restraint. Some measure of control over the availability of credit under inflationary circumstances could be regained if the System were given substantial additional authority over basic reserve requirements of the entire commercial banking system. With such authority, the System could, if necessary, immobilize new bank reserves arising from a return of currency from circulation, gold inflows, and System purchases of securities from nonbank investors and thereby prevent the multiple expansion of the money supply. In addition, the System would need authority to require banks to hold a special reserve in Government bills and certificates. This would be necessary in case banks entered upon an inflationary credit expansion through the

sale of Government securities to the Federal Reserve or in the event it was necessary to assist the Government to finance large deficits without creating additional bank reserves which serve as a basis for multiple credit expansion.

(3) Congress, if it wishes credit and monetary policy to be made by the Federal Reserve System in accordance with the objectives of the Federal Reserve Act and the Employment Act of 1946, could direct the Treasury to consult with the System in the formulation of its debt-management decisions in order that these decisions may be compatible with the general framework of credit and monetary policy being followed by the System in the interest of general economic stability. It is obvious, of course, that Government financing needs must be met and the responsibility of the Federal Reserve to insure successful Treasury financing must continue to be fully recognized. But Treasury financing can be carried out successfully within the framework of a restrictive credit policy, provided the terms of the securities offered are in accordance with that policy.

I recognize that monetary or credit policy by itself cannot assure economic stability. It should be accompanied by a fiscal policy, as well as a bank supervisory policy, in harmony with it.