The "Accord"— A Landmark in the First Fifty Years of the Federal Reserve System

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Personal recollections of the history of institutions may range widely, following the broad avenue of the development of the institution itself, or the high road of the careers of individuals who served it, or they may focus on episodes which stand out in historical perspective as having a special significance. Such an episode in the history of the first fifty years of the Federal Reserve System is the web of events which found its denouement in the "Accord" of the Treasury and the Federal Reserve System in March 1951.

Having chosen to write about this controversial episode, because of special familiarity with it, I faced certain hazards which I have tried to avoid. One such hazard is that episodes of historical significance do not spring into being without a past and, inevitably, they have a future. So it is with the "Accord"; its roots go deep into the past of the Federal Reserve System and its influence is still being felt and its results are still being challenged. Yet, in an article such as this, if one is to avoid the trap of trying to write a history of the Federal Reserve System in a few thousand words, it is possible only to brush over the past of the "Accord" and touch only lightly on its future. A second hazard is that in treating an episode in which one has participated, there is a tendency to embrace the benefits of hindsight. Recourse to records written at the time, and not since "improved", has helped me to avoid this hazard, I hope. But even if the advantages of hindsight are eliminated in this way, there remains the fact that most of the contemporary records I have consulted are the records of individuals or groups who were in the contending forces and only on one side—my side. I have had to try to avoid the hazard that my recollections, refreshed by a reading of written records, are subject to institutional and personal bias.

A fundamental cause of the controversy which led to the "Accord" was the growth in the importance of the overlapping responsibilities of the Treasury and the Federal Reserve during the years 1914-51. On the one side, the deficit financing of two world wars had made the management and cost of the Federal debt a matter of major economic and administrative concern, and the proliferation of Government securities of various maturities brought the Treasury to the market, for financing and refinancing, with increasing frequency. On the other side, the development of credit policy as one of the primary means of Government influence on the total economy, and the open market techniques which the monetary authorities evolved to discharge their responsibilities under law, meant that an overlapping area was created in which understanding and accommodation took the place of rigid legislative directives.

The first sprouting of the conflict inherent in such a situation appeared when the young Federal Reserve System was plunged into the problem of financing the participation of the United States in World War I. The then Secretary of the Treasury notified the Federal Reserve, early in 1917, of his desire to float an issue of certificates of indebtedness at a rate well below the market, which meant that the issue would have to be bought by the Federal Reserve Banks. Subsequently, the Secretary "undertook not to unload anything further on the Federal Reserve Banks, certainly not without notice, and in consideration of his attitude in the matter it was agreed that every effort should be made to bring about a satisfactory organization for shifting Treasury requirements to member banks and, through them, to the public".[1] A working entente was arranged by the System and the Treasury and, eventually, preferential discounting arrangements and preferential discount rates were established to facilitate Treasury financing through the banks of the country. These arrangements—the "bank-borrow-and-buy policy"—persisted for a year after the armistice in November 1918, at the insistence of the Treasury, and were an increasing source of friction between the Treasury and the System as inflationary pressures built up in the postwar economy.

[1] *The Federal Reserve System* by H. Parker Willis (New York, 1923), pp. 1117-18.

The System, in the euphemistic words of the *Annual Report of the Federal Reserve Board for 1920,* was prepared during 1919 to "resort to the well-known method of advancing the rate of discount, as soon as Treasury exigencies permitted".

Perhaps the Federal Reserve System further mingled the areas of responsibility in 1937-38, when the fledgling Federal Open Market Committee, created by the Banking Act of 1935, announced in April 1937 that "with a view to exerting its influence toward orderly conditions in the money market . . . it was prepared to make open market purchases of United States Government securities, for the account of the Federal Reserve Banks, in such amounts and at such times as may be desirable". Since Treasury bills and other short-term Treasury paper had already become bellwethers of the money market, this was an acceptance of responsibility for orderly conditions in the Government security market. In fact, the *Annual Report of the Federal Reserve Bank of New York for the Year 1938* stated that "the open market operations in which this bank participated during the past year were not undertaken primarily with a view to affecting the reserve position of member banks, but rather with a view of exercising an influence toward the maintenance of orderly conditions in the market for Government securities".

This assumption by the credit authorities of a measure of responsibility for maintaining orderly conditions in the Government security market hardened into a compact with the Treasury for the maintenance of a "pattern of rates" in that market to facilitate the financing of the United States participation in World War II. It was recognized by the parties to the compact that, insofar as it was politically and economically possible, the war should be financed out of taxes and that, for the rest, borrowing from nonbank investors (borrowing of savings) would be preferable to borrowing from the commercial banks. It was also recognized, however, that a substantial residue of borrowing would have to be done through the banks, and that this would involve an increase in the money supply (and in the liquidity of the economy) which would not be matched by an increase in goods and services available for civilian use. There was an inevitable inflationary factor in war financing, which was held in check but not removed by direct controls, such as materials priorities and price ceilings. At the time that this general approach to the problems of financing the war was adopted, it was also agreed that to the extent the Treasury had to borrow from the banks, it should borrow at stable, not rising, rates of interest such as the financing methods of World War I had produced. This led to the establishment of a fixed "pattern of rates" which ranged from ⅜ of 1 per cent on ninety-day Treasury bills to 2½ per cent for 20- to 25-year Government bonds (excluding Savings Bonds). As a by-product of this pegging of prices of Government securities, the initiative with respect to the creation of reserve credit was shifted from the Federal Reserve to the member banks.

In the reconversion period, at the end of the war in 1945, the problem facing the Federal Reserve System was how to proceed, and at what speed, to recapture from the banks of the country this initiative, and to restore the ability of the Federal Reserve Banks to place a price upon reserve credit and a check on its availability which could be varied to meet changes in economic circumstances. The Treasury, which had a proper concern for the functioning of the Government security market, which had become habituated to the convenience of the method used to finance the war, which still had the problems of rolling over the war-swollen debt, and which was dubious of the scope left for a flexible monetary policy in the existing circumstances, was reluctant to abandon support prices and a "pattern of rates" for Government securities. In a situation of overlapping responsibilities and on the basis of seniority in the Washington hierarchy, the Treasury assumed the role of final decision. The System wished to discontinue before the end of 1945 its preferential discount rate on Government securities maturing within one year. Treasury acquiescence was not forthcoming until April 1946. From the closing months of 1945, all through 1946, the System was pressing for an end of its artificially low buying rate —⅜ of 1 per cent—on ninety-day Treasury bills, but the Treasury would not agree until July 1947.

These small changes, important in themselves in terms of improving the structure of interest rates, were even more important as an indication of the intention of the Federal Reserve System gradually to restore its control over bank reserves and their availability. It was deemed to be an inevitable consequence of the great wartime increase in the money supply and in the total liquidity of the economy (of business, of consumers, and of the banking system) that inflationary pressures would assert themselves in time, and from time to time, as direct economic controls were removed. An appropriate credit policy would require restraint in the creation of additional bank reserves and would result in increases in short-term interest rates, including rates on short- and intermediate-term Government securities.

The hesitations and refusals of the Treasury meant that the defrosting of the wartime "pattern of rates" took place distressingly slowly, and then only in steps to a higher fixed rate curve ending with the 2½ per cent long-term Government bonds. The supported rate of ⅞ of 1 per cent

on one-year Treasury obligations was not raised to 1 per cent until August 1947, to 1⅛ per cent in November 1947 and to 1¼ per cent in October 1948. The discount rates of the Federal Reserve Banks had to be kept in line with these rates, and were raised equally slowly from 1 per cent to 1¼ per cent in January 1948 and to 1½ per cent in August 1948.

A slight business recession beginning in the fall-winter of 1948-49 provided an opportunity to emphasize the change which was gradually taking place in credit policy and, it was thought, in debt management. An official statement was published, couched in terms of the credit relaxation appropriate to a business downturn, that the "pattern of rates" had finally been abandoned. This was the statement issued on June 28, 1949:

> The Federal Open Market Committee, after consultation with the Treasury, announced today that, with a view to increasing the supply of funds available in the market to meet the needs of commerce, business and agriculture, it will be the policy of the Committee to direct purchases, sales and exchanges of Government securities by the Federal Reserve Banks with primary regard to the general business and credit situation. The policy of maintaining orderly conditions in the Government security market, and the confidence of investors in Government bonds will be continued. Under present conditions the maintenance of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased.

Unfortunately, the acquiescence of the Treasury in the making of this statement by the Federal Open Market Committee was not meant to embrace a policy of flexibility in credit availability and interest rates, except when the flexibility was on the downside. As the economic climate changed and business moved up from the trough of recession, the System-Treasury debate over the coordination of debt management and credit policy resumed.

The persisting differences between the two agencies, of course, had not gone unnoticed in the Congress and in the public press. A subcommittee on Monetary, Credit and Fiscal Policies (Chairman, Senator Douglas of Illinois), of the Joint Committee on the Economic Report, held hearings during the latter part of 1949 and, subsequently, made a report to its parent committee which discussed monetary and debt management policies and took special cognizance of the dispute between the Treasury and the Federal Reserve System. Among other things, it recommended "that an appropriate, flexible and vigorous monetary policy, employed in coordinaton with fiscal and other policies, should be one of the principal methods used to achieve the purposes of the Employment Act [of 1946]". And it went on to recommend, as a means of promoting monetary and debt management policies that would contribute most to the purposes of the Employment Act ". . . that Congress by joint resolution issue general instructions to the Federal Reserve and Treasury regarding the objectives of monetary and debt management policies and the division of authority over those policies. These instructions need not, and in our opinion should not, be detailed: they should accomplish their purpose if they provide, in effect that, (1) in determining and administering policies relative to money, credit and management of the Federal debt, the Treasury and the Federal Reserve shall be guided primarily by considerations relating to their effects on employment, production, purchasing power and price levels, and such policies shall be consistent with and shall promote the purpose of the Employment Act of 1946; and (2) it is the will of Congress that the primary power and responsibility for regulating the supply, availability and cost of credit in general shall be vested in the duly constituted authorities of the Federal Reserve System, and that Treasury actions relative to money, credit and transactions in the Federal debt shall be made consistent with the policies of the Federal Reserve".[2] The press, on the whole, also was favorable to the position of the Federal Reserve. Bankers, insofar as they expressed themselves, were reluctant to take sides.

The unfortunate failure of the Treasury and the Federal Reserve to find common ground for meeting the responsibilities delegated to them by Congress, where their fields of responsibility overlapped, was now approaching a climax. The economy was rapidly recovering from the slight downturn of 1949, when the outbreak of hostilities in Korea, in June 1950, "transformed the tone and the tempo of American economic life".[3] An already buoyant economy became surcharged with inflationary pressures; anticipatory spending by consumers and business reflected expectations of increased Government spending and Gov-

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[2] It should be noted that one member of the subcommittee, Congressman Patman, stated that these proposals did not make the Federal Reserve sufficiently responsible to the Executive Department of the Federal Government and that the Joint Committee in its reference to these recommendations of the subcommittee recommended "further careful study".

[3] Federal Reserve Bank of New York, *Thirty-sixth Annual Report for the Year Ended December 31, 1950*, p. 5.

ernment demand for materials for military purposes; commodity prices were advancing rapidly; bank loans were rising, including business loans, as well as consumer loans and mortgage loans. Confronting this situation, President Truman, in a message to Congress on July 19, 1950 concerning the Korean crisis and the defense program, called for primary reliance upon strong fiscal and credit measures to reduce the volume of private purchasing power competing with the Government for available goods and services. And, in his midyear Economic Report (July 26, 1950) there was this statement: "First of all for the immediate situation, we should rely in major degree upon fiscal and credit measures . . . the more prompt we are with these general measures the less need there will be for direct controls. . . ."

So far as the Federal Reserve was concerned, these statements of over-all national policy confirmed its view of what it should be doing to help counteract the forces of inflation, not only by way of selective controls of consumers and mortgage credit but, more important, by general credit measures without which selective controls would not be effective. The Federal Reserve view, reaffirmed and reinforced in the light of the Korean crisis, had been given to the Secretary of the Treasury earlier in July, when it was stated that the System could not maintain the existing rate structure in the Government security market while going forward with the general policy of regaining control of the initiative with respect to bank reserves which it deemed essential; either short-term rates would have to rise or the long-term rate would have to come down, and both from the standpoint of countering inflationary pressures and correcting an artificial interest rate structure, it preferred the first alternative. The Treasury reply counseled delay until the situation became clearer, and emphasized that the nation was waiting to learn what domestic programs might be needed in order to utilize the full strength of the country in national defense. The Federal Reserve System believed that the messages of the President had now answered the question.

The action question, which remained on the agenda of the Federal Open Market Committee, was what contribution it would make to the general program in its sphere of primary responsibility; what it would do about making further reserve funds available to the banking system in an inflationary situation which could quickly become critical and in which the effectiveness of moderate general credit measures of restraint would depend upon the promptness of their use. The Federal Reserve felt that it was under the compulsions of statutory responsibility to meet a present danger, and that it had exhausted the possibilities of devising a mutually agreeable program with the Treasury which would have permitted credit policy and debt management to go forward in tandem.

So it was, on August 18, 1950, the Board of Governors of the Federal Reserve System approved an increase in the discount rate of the Federal Reserve Bank of New York from 1½ per cent to 1¾ per cent (effective August 21), which had been held in abeyance for about a month, and the Federal Open Market Committee adopted a general policy of making reserves less readily available to the banks of the country, and then informed the Treasury of what it was doing. Up to this point, the Federal Reserve had presented its views concerning an appropriate combination of credit policy and debt management to the Treasury; the Treasury had decided what it was going to do and had then informed the Federal Reserve; and the Federal Reserve had followed along, attempting to adjust its open market operations, as best it could, to the debt management decisions of the Treasury. The August 1950 decision reflected the Federal Reserve's belief that the facts of the economic situation and the general economic program of the Government demanded that it break out of that pattern.

Advice of the actions taken was immediately given, orally, to the Secretary of the Treasury by the Chairman and Vice Chairman of the Federal Open Market Committee (afternoon of August 18, 1950). A delayed response without further conference came within the hour. The Treasury had decided to announce its September-October refunding—a $13.5 billion operation—at once, maintaining the existing rate of 1¼ per cent for one-year obligations. (The actual offering was a thirteen-month note.) The result was an issue which was a market failure—the Federal Reserve had to purchase the larger part, upward of 80 per cent—of the maturing securities in order to make sure that the Treasury would not have an embarrassing cash redemption. At the same time, as an offset to the effect of these purchases on bank reserves, the Federal Reserve sold other securities from its portfolio at prices and yields in line with its actions on discount rates and open market policy.

There followed a period of confused and confusing attempts to re-establish a working formula for coordinating debt management and credit policy. The President of the United States was early brought into the embarrassing dispute by the Treasury. A temporary truce was evolved which permitted time to observe the results of the actions taken by the Federal Reserve and, in November 1950, there was a fairly amicable agreement embracing credit policy and the Treasury refunding of its December and January maturities with a 1¾ per cent five-year note. As it turned out, the new note did not fare well and, in terms

of the amount of the maturing issues which the Federal Reserve had to buy and the amount which the market redeemed for cash, the financing was not a success.

The Treasury evidently felt that it had been let down, and that some public statement had to be made to restore confidence in the Government security market. In a speech at New York, on January 18, 1951, the Secretary of the Treasury declared that "the delusion that fractional changes in interest rates can be effective in fighting inflation must be dispelled from our minds"; that "any increase in the 2½ per cent rate for long-term Government securities would seriously upset existing security markets"; and that "the Treasury Department had concluded, after a joint conference with President Truman and Chairman McCabe of the Federal Reserve Board, that refunding and new money issues of the Treasury will be financed within the pattern of that rate". This attempted re-establishment of a "pattern of rates" in Government financing, and the implication of a commitment by the Federal Reserve to support the 2½ per cent long-term rate on new as well as outstanding issues of Treasury securities was immediately challenged, most notably by Marriner Eccles, a member and former Chairman of the Board of Governors, in testimony at a hearing of the Joint Committee on the Economic Report which was then in session.

Amid a rising volume of public comment on, and Government concern over, the differences between the Treasury and the Federal Reserve System, it was announced on January 31, 1951, that President Truman had asked the members of the Federal Open Market Committee to come to the White House that afternoon. There followed a bizarre exchange of contradictory reports on what had taken place at the meeting. A White House press secretary said that the Federal Reserve had pledged its support to President Truman in maintaining the stability of Government securities as long as the emergency lasted. A Treasury spokesman said that the White House statement meant that the market for Government securities would be stabilized at their present levels and that these levels would be maintained during the emergency. These press reports, which left a cloud of doubt as to what had happened at the White House meeting, were given official sanction in a letter from the President to Chairman McCabe which was released to the press on February 1, 1951. In it the President wrote, "your assurance that you would fully support the Treasury defense financing program, both as to its refunding and new issues, is of vital importance to me. As I understand it, I have your assurance that the market on Government securities will be stabilized and maintained at present levels in order to assure the successful financing requirements and to establish in the minds of the people confidence concerning Government credit".

This was at variance with what the Federal Open Market Committee believed had been said and done at the White House meeting. In a memorandum prepared immediately after the meeting, the Federal Reserve recorded that there had been no references to recent disputes with the Treasury; and that at no time had the President indicated that he had in mind support, or a pledge of support, of the financing program recently outlined by the Secretary of the Treasury (January 18, 1951 at New York). Shocked by the public letter of the President to Chairman McCabe, Governor Eccles released the Federal Reserve record to the press on his personal responsibility, on February 3, 1951.

An intolerable situation had been created in which, as the Federal Open Market Committee said in a letter to the President on February 7, 1951, "You as President of the United States and we as members of the Federal Open Market Committee have unintentionally been drawn into a false position before the American public—you as if you were committing us to a policy which we believe to be contrary to what we all truly desire, and we as if we were questioning you and defying your wishes as the chief executive of the country in this critical period". The letter went on to say that "in accordance with our assurance to you, we shall seek to work out with the Secretary of the Treasury as promptly as possible a program which is practical, feasible and adequate in the light of the defense emergency, which will safeguard and maintain public confidence in the values of outstanding Government bonds and which, at the same time, will protect the purchasing power of the dollar".

Concurrently with the sending of this letter to the President, a meeting of the Chairman and Vice Chairman of the Federal Open Market Committee was held with Senate leaders of the Banking and Currency Committee, a subcommittee of which had been named to inquire into the Treasury-Federal Reserve controversy. The general tenor of the senatorial advice was that it was no time for feuding and no time for a Congressional hearing, but a time for the Treasury and the Federal Reserve to try again to compose their differences. The same advice was given by the Senator Chairman of the Committee on the Joint Economic Report, the following day.

This counsel from members of the Congress, from which the Federal Reserve System derives its authority and powers, coincided with the wishes of the Federal Open Market Committee, which on the same day (February 7, 1951) that it had written to the President, drafted a letter to the Secretary of the Treasury expressing a desire "to discuss credit policy and debt management programs which

would assist in the highly important fight against inflation and improve public confidence in the market for Government securities", and suggesting a program as the basis for such a discussion. This letter was handed to and discussed with the Secretary of the Treasury by the Chairman and Vice Chairman of the Federal Open Market Committee. (At this meeting, for the first time, Mr. William McC. Martin, Assistant Secretary of the Treasury, took part in the discussion.)

The matters at issue were now back on the track of responsible discussion by the two agencies of Government whose overlapping responsibilities had erupted into controversy, although there were still a few detours to be traversed. Before the proposed discussions could begin, the Secretary of the Treasury had to enter a hospital to recuperate from an operation and the Treasury sought a commitment from the Open Market Committee that there would be no change in the existing situation in the Government security market during the period of his hospitalization. This was a commitment which the Committee felt unable to give in the face of mounting inflationary pressures, and a Government security market which was demanding heavy purchases by the Federal Reserve, contrary to the policy and program which it thought the economic situation required. The Committee asked the Secretary to name someone at the Treasury with whom it could talk, in the interim, and the Secretary named Mr. Martin.

Negotiations now took a turn for the better. Mr. Martin suggested that members of the staff of the Treasury Department and of the Federal Reserve meet as soon as possible to go over the proposals contained in the February 7 letter of the Federal Open Market Committee to the Secretary of the Treasury, and such other ideas as might be brought forward. (Chairman McCabe had previously suggested such staff conferences, but the Secretary of the Treasury had said he preferred to settle matters at the policy level and then have the details worked out at staff levels.) A working party was created[4] and progress began to be made toward understanding at the "technical level" for referral to the "policy level", as the Treasury phrased it, although the negotiation faltered at times.

While these discussions were going on, the White House again intervened. A meeting was called by the President on February 26, 1951, including the Director of Defense Mobilization, the Under Secretary of the Treasury (in the absence of the Secretary), the Assistant Secretary of the Treasury (Mr. Martin), the Chairman of the Securities and Exchange Commission, the Chairman and Vice Chairman of the Federal Open Market Committee, the members of the Council of Economic Advisers and the special counsel of the President. At this meeting the President began by reading a memorandum (which was also released to the press), in which he expressed his concern with the problem of reconciling the need to maintain stability in the Government security market and the need to restrain credit expansion; outlined the general economic program of the Administration; and requested the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization and the Chairman of the Council of Economic Advisers to study the problem of the overlapping responsibilities of the Treasury and the Federal Reserve System. He also expressed the hope that "while this study is under way, no attempt will be made to change the interest rate pattern, so that stability in the Government security market will be maintained". This intervention was different in form from previous interventions and came more nearly to grips with the problem, but it also failed to recognize that the Federal Reserve has duties laid upon it by the Congress which cannot be abandoned to the arbitration of *ad hoc* committees. Fortunately, the Treasury-Federal Reserve "Accord" was reached while the Presidential committee was still pondering the problem, and when its report was later completed it apparently was "filed".

The tenor of informed thinking in the Congress, which was the only place the dispute could be decided, in default of agreement by the two agencies directly involved, was indicated in a powerful speech by Senator Douglas in the Senate chamber on February 22, 1951, which he concluded with a plea "that the Treasury abate its policies and yield on this issue" and that "the Federal Reserve gird its legal loins and fulfill the responsibilities which I believe the Congress intended it to have".

Meanwhile, the negotiations of the principals in the dispute regained their momentum. On February 28, the staff negotiators felt that matters were sufficiently well in hand to warrant presentation to their principals and, that evening, the Secretary of the Treasury was consulted by Mr. Martin and the request was made by the Secretary that Mr. Martin and Mr. Bartelt be permitted, orally, to present to the Federal Open Market Committee the response of the Treasury to the Committee letter of February 7, 1951. Consideration of this report by the Commit-

[4] Mr. Martin, Mr. George Haas, Director of Technical Research, and Mr. Edward Bartelt, Fiscal Assistant Secretary, from the Treasury and Mr. Winfield Riefler, Assistant to the Chairman of the Board of Governors and Secretary of the Federal Open Market Committee, Mr. Woodlief Thomas, economist of the Committee, and Mr. Robert Rouse, Manager of the System Open Market Account and Vice President of the Federal Reserve Bank of New York.

tee evoked a generally favorable response, and the staff group of the Committee was requested to resume its discussion with the Treasury group, in the light of the views expressed by the members of the Committee.

The Federal Open Market Committee met again on March 2 and Mr. Riefler reported the results of the final staff conference with the Treasury representatives. There ensued a further discussion of all of the points on which agreement was being sought, and a concise statement of a program acceptable to the Open Market Committee was written and given to Messrs. Martin and Bartelt for their consideration, and later discussed with them at length by Messrs. McCabe, Sproul, Riefler, and Thomas. A meeting of minds was achieved along the following lines:

1. Purpose—to reduce to a minimum the creation of bank reserves through monetization of the public debt, while assuring the financing of the Government's needs.

2. A conversion offering by the Treasury which would be designed to remove a substantial amount of the long-term restricted[5] 2½ per cent bonds from the market.

3. Support of the market for the outstanding restricted 2½ per cent bonds by the Federal Open Market Committee at par or slightly above for a limited amount and only during the brief period of the conversion offering.

4. With the exception of this support, the maintenance of orderly market conditions, hereafter, to be without reference to the maintenance of the par value of any Treasury issues.

5. Reduction or discontinuance of purchases of short-term Government securities by the System Open Market Account, so as to permit yields on such securities to fluctuate around the discount rate (1¾ per cent) and thus to make that rate effective, with the understanding that it would not be changed during the remainder of the year, except in compelling circumstances.

6. Prior consultation between the Treasury and Federal Reserve on changes in debt management or credit policy, unless extraordinary circumstances made such prior consultation impossible.

7. The public statement of agreement to be brief, financial and nonpolitical.

The terms of agreement were taken by Mr. Martin to the Secretary of the Treasury, at the hospital, and the program was cleared with him and then with the members of the Federal Open Market Committee on March 3, 1951. The following statement and announcement appeared in the press on Sunday, March 4, 1951:

> Joint announcement by the Secretary of the Treasury and the Chairman of the Board of Governors and of the Federal Open Market Committee of the Federal Reserve System.
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> The Treasury and the Federal Reserve System have reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt.

Simultaneously, the Secretary of the Treasury announced that there would be an offering for a limited period of a new investment series of long-term nonmarketable Treasury bonds in exchange for the two longest outstanding restricted Treasury bonds (the 2½ per cent bonds of June and December 1967-72). The details of this offering were announced March 19. The offering was a 2¾ per cent bond of 1975-80 which, while nonmarketable, could be converted at the holder's option into five-year marketable notes carrying a coupon of 1½ per cent. More than two thirds ($13.6 billion) of the outstanding 2½ per cent bonds of 1967-72 were turned in for the new 2¾ per cent bonds in this first offering. (A year later another $1.8 billion of the new bonds were issued in exchange for the four longest issues of outstanding restricted bonds.)

During the transition period, over the next six weeks, the System Open Market Account and some of the Treasury investment accounts purchased substantial amounts of long-term Treasury bonds at declining prices, in order to ease the adjustment in the market to the final abandonment of the "pattern of rates" and its long-term anchor of 2½ per cent. By April 12, 1951 the initial price adjustments were completed and the market "bottomed out". Happily, the inflationary pressures which had brought matters to a head between the Treasury and the Federal Reserve subsided after the first quarter of 1951, and for this the release of monetary policy from the shackles of a "pattern of rates" received a modicum of credit.

If it is too much to say that the Treasury and the Federal Reserve have lived happily ever after the "Accord", they at least have learned to get along together with a minimum of marital friction.

There could be discord again, of course, but it is less likely if the experience and lessons of the "Accord" period are remembered. As a contribution to this remembrance, here are some gleanings.

1. In situations and areas where debt management and credit policy overlap, neither the Treasury nor the Federal Reserve System should make final decisions without

[5] I.e., purchase restricted to noncommercial bank investors.

responsive consultation and without due regard for the responsibilities and views of its partner.

2. Continuous communication provides the basis for such sharing of responsibility. In the pre-"Accord" period there was a failure of communication which helped to lead to the breaking of this rule. The Federal Reserve thought it understood the position of the Treasury, but it may not have. There is good reason to believe that the Treasury did not understand the position of the Federal Reserve. For the latter lack of understanding, the Federal Reserve bore some blame. Although its basic objective was to regain the initiative with respect to the creation of bank reserves, much of its argument with the Treasury was couched in terms of interest rates. The interest rate structure, of course, was the place where Federal Reserve policy would directly and obviously impinge on debt management, but concentration on small changes in interest rates tended to reduce discussion to a question of "hat sizes" in the minds of the Treasury and, to some extent, of the Congress and the public. The Federal Reserve had come to believe, however, that with a greatly enlarged Federal debt and a nearly homogeneous national money market, an opportunity had been created for effective action with limited variation in interest rates and that, for the time being, its objectives could be achieved by restoring modest rate flexibility at the short end of the rate structure.

3. In the absence of understanding and acceptance of this belief, the Treasury viewed with some doubt the strength of purpose of the Federal Reserve to maintain the 2½ per cent rate on outstanding long-term Treasury bonds, since the maintenance of this ceiling on the rate structure limited the permissible variation of rates lower down the maturity schedule. The Federal Reserve was aware of this restriction, but was willing to accept it for a time because of its belief that there would need to be an extensive shifting in the portfolios of investing institutions out of long-term Government securities and into corporate bonds, mortgages and other debt instruments of the private sector of the economy in the reconversion period, and that this shift would have to be eased along if serious market unsettlement was to be avoided. In performing this orderly market service, the Federal Reserve tried to offset the effect of its bond purchases on bank reserves by selling equivalent amounts of short-term Government securities, and had considerable success. Continued success in this maneuver, however, needed the assistance of higher interest rates on the short-term securities being sold.

4. Finally, in the catalogue of misunderstanding, there was the general Treasury opinion that the credit program which the Federal Reserve wished to follow would be of little use in combating inflationary pressures, particularly in the Korean period, and that "experimenting" with the interest rate structure could weaken faith in the Government security market and in the credit of the Government at a time when major war financing might be necessary. The Federal Reserve, on the contrary, believed that faith in Government credit and confidence in Government securities would be destroyed if it became apparent that monetary policy was to be prevented from fighting inflationary pressures and that a dollar invested in Government securities would be a shrunken dollar when the securities matured.

Up to the time of the Korean crisis, the Federal Reserve was content to carry on a holding operation. It joined with the Treasury in opposing those who, in the immediate postwar years, counseled abrupt and vigorous use of credit policy to reduce the swollen money supply, inherited from the war, and to wring excess liquidity out of the economy. Rather, it took the position that the economy would have to grow up to the money supply (which it rapidly did) and that, meanwhile, release of inflationary pressures suppressed by direct control during the war period would be partially offset by increases in the national product (as they were). In the face of the economic repercussions of the Korean crisis, however, such an approach was no longer practical.

5. The Korean confrontation focused attention on the core of the problem. Coequal Government agencies, with certain overlapping responsibilities, had been unable to arrive at a common policy other than by the subordination of one agency to the other. Various answers to this problem were suggested.

(a) A clearer Congressional mandate. There is no clear mandate to the Treasury with respect to the broader economic implications of debt management and no clear mandate to the Federal Reserve System with respect to the maintenance of price stability and the international position of the dollar. As mentioned earlier, a subcommittee of the Joint Economic Committee—in 1950—recommended that it be expressed as the will of Congress that transactions with respect to money and credit and transactions in the Federal debt be made consistent with the policies of the Federal Reserve. This recommendation followed the dictum of Senator Douglas that "good fences make good neighbors", but when the location of the property line is uncertain and the line may change at times, "good fences" are not an adequate answer.

Both the Treasury and the Federal Reserve have affirmed that, in addition to Congressional directives applying to them specifically, they consider themselves bound by the declaration of policy set forth in the Employment

Act of 1946. What remains to be done, in terms of a Congressional mandate to the Federal Reserve System, it seems to me, is to include a reference to price stability among the general guides to economic well-being in the preamble of the Employment Act, and to add a general directive with respect to price stability and the international position of the dollar to the Federal Reserve Act.

This will not satisfy those who believe that a central bank should pursue a primary objective—stable purchasing power of the monetary unit—without being diverted by a wider range of economic objectives such as are set forth in the Employment Act of 1946. Certainly the Federal Reserve System must have its own objectives in the field of monetary policy and realize its capacities and limitations, but I do not believe that it is possible in the light of the Employment Act, and what it reflects of national purpose, for the central bank to be completely free.

(b) Another suggestion for resolving conflicts of the Treasury and Federal Reserve, where their interest and duties overlap, and which usually draws considerable support, is the establishment of an interagency consultative committee or a national monetary and credit council, which would bring together the heads of a number of Government agencies having responsibilities related to credit policy and debt management. This would be expected to provide for informal collaboration, although the body would be without directive powers, which most agree would be an usurpation of Congressional authority. This sort of thing sounds good in conversation and looks good on paper, but the only people who can resolve differences arising out of overlapping statutory responsibilities are people who bear the responsibility and know what it is all about—that is the people at the Treasury and in the Federal Reserve System in this case. A committee or council of the sort proposed either languishes on the vine because of a lack of authority, or becomes a means of exerting executive pressure on a body (the Federal Reserve) which draws its powers from the Congress.

(c) There are some who think, of course, that the Federal Reserve System should be made more responsive to the Executive Branch of the Government and, presumably, that the President by virtue of his office or the power of his presence should be able to order a composition of contrary views held by Treasury and Federal Reserve officials. Whether as a three-man body, with the President holding the balance between Treasury and Federal Reserve, or as a council made up, on one side, of a number of individuals holding Presidential appointments and owing Presidential loyalty as a part of a political administration and, on the other side, by a representative of the Federal Reserve System, this kind of proposal has little to recommend it. In the words of a witness (Beardsley Ruml, formerly Chairman of the Board of the Federal Reserve Bank of New York) at the hearing of the Patman subcommittee of the Joint Committee on the Economic Report in 1952, bringing the President in to settle differences between the Federal Reserve and the Treasury would mean that one or both parties to the disagreement would devote their efforts to procuring a favorable opinion from the President, and would lead to the use of force rather than reason in dealing with an agency of Congress which has statutory duties. "Nothing but harm to public confidence in both money and Government would result."

This is not to say that the Chairman of the Board of Governors should not discuss the problems of the Federal Reserve System with the President, alone or with the Secretary of the Treasury. That is natural and, at times, desirable. But to make this a regular means of coordination of policies can lead to dictation instead of persuasion, as the experience of the pre-"Accord" period attests.

(d) Then there are those who would substitute an invariable formula for fallible human judgment or weak human resolve in directing monetary affairs and, so long as the Federal Reserve followed the formula (if it retained its job at all), the Treasury (and everyone else) would have to accommodate its objectives to the working of the formula. Ideally, one exponent of this theory says[6] "the surest way to achieve the aim of a stable monetary structure is . . . to legislate a rule specifying the behavior of the quantity of money. The rule I favor is one which specifies that the quantity of money shall grow at a steady rate from week to week, month to month, and year to year". But when this invariable formula is related to an existing and future state of affairs, and when account is taken of the lag between monetary action and its economic effects, he says that "the problem of lag in reaction and the fact that the effects are spread over a period is not a problem that can be solved by just looking at the quantity of money. In order to solve that problem or in order to eliminate that difficulty it would be necessary to forecast what is going to happen much better than we now can". So, in point of fact, except as an assertion that an invariable formula would have made fewer mistakes than have been made without such a formula, he says we do not "know enough now to set up a formula . . . which would do more good than harm". I am willing to wait, at

[6] Professor Milton Friedman at the hearings on "The Federal Reserve System after Fifty Years", held by the Subcommittee on Domestic Finance of the Committee on Banking and Currency, House of Representatives, March 3, 1964.

least until we have more persuasive arguments that a rigid invariable formula can ride through the continuing changes in the economic environment, without the benefit of human judgment and without causing major errors instead of minor ones.

My own conclusion is that the experience of the "Accord" leads to a more human and natural solution of the problem of the overlapping responsibilities of the Treasury and the Federal Reserve than any of the corrective devices which have been suggested. It is the solution which has been working since the "Accord". It involves the recognition that Treasury and the Federal Reserve are coequals in the area of their overlapping responsibilities. It is based on the assumption that informed and responsible men recognize that, in our form of Government, such sharing of responsibility requires thorough discussion of divergent views and every effort to merge them into a common purpose. It demands that there be open and frequent communication between those who determine policy, that the makers of policy have staffs of the highest competence which also are in open and frequent communication, and that the policy makers have a sufficient understanding of the theory and practice of their art to be able to add wisdom to knowledge when positions show signs of becoming unyielding. Finally, it assumes that the Congress, presumably through the Joint Economic Committee on the Economic Report, will continue to monitor performance and to provide evidence of the attitude of Congress toward performance because, if irreconcilable differences do arise, the Congress must be the final arbiter in matters concerning the power to regulate the "people's money".

The Federal Reserve challenge to the Treasury's assertion of dominance in the area of their overlapping responsibilities prior to the "Accord" had its ultimate justification in the achievement of coequal status in these matters, and not as an assertion of a false independence. The Federal Reserve does not have, never has had, and never has claimed to have an independence in monetary affairs which divorces it from the general economic policies of the Government.