

The Treasury-Fed Accord: A New Narrative Account

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The fiftieth anniversary of Federal Reserve Independence Day was March 4, 2001. After World War II ended, the Fed continued its wartime pegging of interest rates. The Treasury-Fed Accord, announced March 4, 1951, freed the Fed from that obligation. Below, we chronicle the dramatic confrontation between the Fed and the White House that ended with the Accord.¹

1. THE CHALLENGE TO THE TREASURY

In April 1942, after the entry of the United States into World War II, the Fed publicly committed itself to maintaining an interest rate of 3/8 percent on Treasury bills. In practice, it also established an upper limit to the term structure of interest rates on government debt. The ceiling for long-term government bonds was 2 1/2 percent. In summer 1947, the Fed raised the peg on the Treasury bill rate.² However, the Treasury adamantly insisted that the

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¹ The narrative account of the Accord offered here draws primarily on the minutes of the Federal Open Market Committee and its Executive Committee and a biography and autobiography of Marriner Eccles, as well as on other primary and secondary sources. The reminiscences are from Ralph Leach who, as a staff economist at the Board of Governors, participated in these events.

² Given the floor placed under the price of long-term securities, they were as liquid as short-term securities. Individuals and institutions then had no incentive to hold short-term securities. By

Fed continue to place a floor under the price of government debt by placing a ceiling on its yield.

After World War II, the predominant concern of public policy was to prevent a return of the Great Depression and high unemployment.³ However, the primary postwar problem turned out to be inflation rather than economic depression. Over the 12-month periods ending June 1947 and June 1948, respectively, CPI inflation was 17.6 and 9.5 percent.

This inflation arose from the end of wartime price controls and ceased in summer 1948. The recession that began in November 1948 temporarily rendered moot the issue of interest rate ceilings. However, the change in the intellectual and political environment begun during the economic depression of the thirties and reinforced by the economic boom of the forties assigned to government an active role in economic stabilization. Inevitably, the Fed would want to establish a role in controlling inflation and dealing with recession. By the time inflation threatened a second time with the outbreak of the Korean War, five years of relative economic stability had made the threat of a return to the depression of the thirties seem less real. Nevertheless, the Fed was not in a position to win a contest of wills with the Treasury and rid itself of the obligation to maintain the price of government bonds.⁴

Ralph Leach joined the Fed right before the events that provoked open confrontation between the Federal Reserve System and the Treasury. After serving in World War II in the South Pacific, he managed the Treasury portfolios of two moderately sized banks, first in Chicago and later in Phoenix. In both cases, he was an active trader of government securities. He developed a telephone acquaintance with all the major Treasury dealers and joined them in the daily routine of guessing what the actions of the Fed's New York Trading Desk would be.

In spring 1950, the Federal Reserve Board decided to add someone with market experience to its Washington staff. Some of Leach's associates recommended him. After talking with Winfield Riefler and Woodlief Thomas, Leach accepted the position of Chief of the Government Securities Section of the Research Division.⁵

1947, basically only the Fed held short-term securities. Raising the rate the Treasury paid on them had no consequences for the Treasury as the Fed recycled the interest payments to the Treasury.

³ Goodwin and Herren (1975) offer an excellent overview of the political and intellectual environment that shaped monetary policy in the post-World War II period.

⁴ Friedman and Schwartz (1963, Chapter 9, "Cyclical Changes, 1933-41") relate how the Fed had not conducted an active monetary policy since 1933.

⁵ To make a case for an independent monetary policy directed toward economic stabilization, policymakers had to rely on the persuasiveness of their ideas. For this reason, Fed economists played an indispensable role in achieving the Accord. The most important was Winfield B. Riefler.

Thomas McCabe accepted the position of Chairman of the Board of Governors in 1948 on the condition that Winfield B. Riefler accompany him to Washington as personal adviser. Leach recalls Riefler as an extraordinary individual with an exceptional background. He dominated discussion with the force of his intellect and no one could best him in an argument.

The Korean War broke out the day before Leach started his new job. Both Riefler and Thomas came to his office to say they felt they had done him a disservice. They feared that war would lead to the continued pegging of the government securities market rather than the development of a free market that would permit an independent monetary policy. In fact, the opposite occurred.

Particularly since its meeting on June 13, 1950, the FOMC had chafed at the straitjacket imposed by the rigid regime of rate pegging.⁶ After the trough of the business cycle in October 1949, the economy had recovered strongly. Fearful of an economic boom that would revive inflation, at the June meeting New York Fed President Allan Sproul had recommended raising short-term rates by 1/8 percent.⁷ Although long-term bonds were selling

In the twenties, Riefler had worked at the Board of Governors in Washington. While there, he developed the table in the *Federal Reserve Bulletin* currently called "Reserves of Depository Institutions and Reserve Bank Credit," which provides a consolidated Treasury-Fed account of the factors that supply and absorb bank reserves and currency. In a Ph.D. thesis originally written at the Brookings Institution and later published as a book, Riefler (1930) showed how Fed actions that affect bank reserves influence short-term interest rates.

In the early thirties, Riefler left the Fed for the Roosevelt Administration, where he helped write the Federal Housing Act. He conceived and developed the idea of the self-amortizing home mortgage, before which home mortgages had matured in five years and required full payment of the principal at the end. After leaving government, Riefler joined the Institute for Advanced Studies at Princeton.

Riefler wanted to reestablish Fed independence and to reorient monetary policy to the goal of economic stabilization. He realized that his goal would require a free market in government securities. Not only would the Fed have to abandon its bond support program, but it also would have to allow and encourage the market to set government bond prices. It is hard to imagine now, but at the time there was no free market in government securities.

⁶ The FOMC comprised all the Board governors and the five regional Bank governors who were voting members. Because New York always voted, only four of the other regional Bank presidents attended FOMC meetings. The difficulty of transportation limited the ability of all regional Bank presidents to attend. The FOMC issued the directive as a guide to monetary policy. However, the directive changed only infrequently. Its language reflected the phase of the business cycle and accordingly stated whether the primary goal of monetary policy was to restrain inflation or to encourage economic activity.

At that time, the full FOMC left the implementation of the directive to the Executive Committee. Because the Executive Committee issued operational instruction to the Desk, it actually made monetary policy. The Executive Committee comprised the Board Chairman, two governors, the president of the New York Fed, and one regional Bank president. The FOMC met about five times a year and the Executive Committee met separately six or seven times a year. Two members, Allan Sproul (President of the New York Fed) and Marriner Eccles (Board governor), dominated the Executive Committee.

⁷ Allan Sproul was one of the giants of central banking. Sproul joined the San Francisco Fed in 1920. As Secretary of the Bank, he traveled to Washington for meetings on monetary policy. His abilities attracted the attention of Benjamin Strong, the legendary first governor of the New York Fed, and George Harrison, who succeeded Strong. Harrison brought Sproul to New York in early 1930. Sproul became Harrison's assistant and later managed open market operations for the New York Desk. He became President of the New York Fed in 1941 (see Sproul [1980], Chapter 1).

In the twenties, the New York Fed had functioned as the central bank of the United States (Friedman and Schwartz 1963, Chapter 6). Allan Sproul wanted to reestablish the earlier dominant position of the New York Fed. In 1946, he turned down an offer to head the newly formed World Bank because of the importance he assigned to reviving monetary policy (Sproul 1980, p. 11). Sproul was the preeminent central banker within the Fed. He could articulate ideas and was the first FOMC member to bring to the FOMC table the idea that became a rallying point for the

above par (yielding less than the 2 1/2 percent ceiling), everyone knew that the Fed's Rubicon would be a rise in short-term rates incompatible with this 2 1/2 percent wartime ceiling. Sproul commented, "[I]f we are faced with the decision whether to let long-term bonds go below par, I would let them go below par" (FOMC Minutes, 6/13/50, p. 87).

At the August meeting, the FOMC decided to challenge Treasury Secretary Snyder's unwillingness to allow any rise in rates, short-term or long-term. Later, President Sproul expressed the frustration the Committee had experienced in dealing with the Secretary:

[W]e had been discussing these problems with him for more than a year...[H]e had discussed them with us little or not all...[H]e had usually turned to an associate and usually asked if they had any comment to make and then said that he would let us know what he was going to do...[T]hat had usually been followed by an announcement by him, often anticipating far in advance his needs, of the financing program which had differed almost completely from our recommendations and which had had the effect of freezing our position [by announcing security offerings at the pegged rates]. (FOMC Minutes, 2/6/51, p. 69)

In the summer of 1950, the FOMC had asked the Treasury to replace the 2 1/2 percent marketable bonds with nonmarketable bonds. If market forces pushed up long-term interest rates, the Fed would not have to buy the nonmarketable bonds. However, the Treasury refused the Fed request (FOMC Minutes, 8/18/50, p. 131). These one-way conversations reflected the Treasury's dominant position.

A telling example occurred on the day of the August FOMC meeting. At the Treasury's invitation, members of the FOMC went to the Treasury after lunch to see a chart show on the distribution of Treasury securities by class of investor. However, before they went, Treasury Representative Mr. Haas called. He announced "that, while he would be glad to show the slides to members of the Committee and the staff, he and the staff could not spare the time for a discussion of the figures" (FOMC Minutes, 8/18/50, p. 133).

At the August FOMC meeting, Sproul raised the challenge. He referred to the Fed's fruitless discussions with the Treasury and said, "We have marched up the hill several times and then marched down again. This time I think we should act on the basis of our unwillingness to continue to supply reserves to the market by supporting the existing rate structure and should advise the Treasury that this is what we intend to do—not seek instructions" (FOMC Minutes, 8/18/50, p. 137).

Fed in its effort to end the interest rate peg. Namely, the Fed should control bank reserves and let the market determine the interest rate.

Governor Eccles agreed with Sproul that if the System “expected to survive as an agency with any independence whatsoever [it] should exercise some independence” (FOMC Minutes, 8/18/50, p. 137).⁸ Despite concern about the Treasury refunding of the September 1 1/4 percent certificates maturing in two weeks, the FOMC agreed to raise the interest rate on one-year Treasury securities from 1 1/4 to 1 3/8 percent. The members of the Board of Governors also decided to approve the recommendation of the New York Fed to increase the discount rate from 1 1/2 to 1 3/4 percent. Chairman McCabe and Vice Chairman Sproul then prepared to go to the Treasury to inform Secretary Snyder of the FOMC’s decision.⁹

However, the question arose of what the FOMC should do if the Treasury preempted its action by announcing an immediate refunding of the one-year securities at the existing 1 1/4 percent rate (FOMC Minutes, 8/18/50, p. 147). Leach recalls asking Chairman McCabe if he could make a comment on the market. McCabe replied, “We don’t have opinions on the market down here—we rely on New York for those opinions.” After an awkward silence, Sproul turned to Leach and said, “I would like to hear your comment.” Leach’s suggestion was that the Board announce the discount rate change after the market closed that day (Friday), but with no comment.

Leach recalls arguing that the New York Desk should put out a par bid for all of the new Treasury issue when the market opened Monday morning. The result would be that the New York Desk would purchase the Treasury issue at the (“high”) price consistent with the current rate peg. However, as the Desk bought the new issue, it would sell other short-term issues at (“low”) prices consistent with the desired rise in interest rates. That action would prevent

⁸ President Roosevelt had appointed Marriner Eccles Chairman (then called “governor”) of the Board of Governors effective November 15, 1934. First Roosevelt and then Truman reappointed him to successive four-year terms in that position. However, when his term expired January 29, 1948, in a move that surprised Eccles, Truman declined to reappoint him (see “Knifed” in Hyman [1976]).

Truman did not explain his decision. Although Eccles never learned the reason, he considered two possibilities (Hyman 1976, p. 339). Treasury Secretary Snyder may have wanted to get rid of him as an “abrasive adversary.” Alternatively, in a presidential election year, Eccles was a political liability to Truman in California. Eccles was a fierce opponent of the attempt by California banker A. P. Giannini to use the holding company Transamerica to expand the branch bank network of the Bank of America in California. Eccles’s term as Board governor did not expire until 1958. Although no longer Board Chairman, he remained on the Board of Governors. (He retired in July 1951.)

Eccles had believed that the government should use fiscal policy (what he called compensatory finance) to stabilize the economy (see Eccles [1951]). Only gradually did he come to believe that the Fed should control reserve creation by allowing the market determination of interest rates. Once converted to that view, he provoked the ultimate confrontation with the White House.

⁹ Thomas B. McCabe, Chairman of Scott Paper Company, replaced Eccles as Chairman of the Board of Governors. McCabe had been chairman of the Philadelphia Fed’s Board of Directors. Leach recalls that McCabe made the Accord possible through the professional, honest way that he presented the case for monetary independence to the executive branch and Congress.

failure of the refunding because the Fed would buy the Treasury issues. At the same time, it would raise short-term interest rates.

Sproul asked for a short recess during which he, Robert Rouse (head of the New York Trading Desk), and Leach discussed the probable market response. Sproul then endorsed the plan and the FOMC approved it. The Board of Governors approved the discount rate increase, which it announced without comment after the market closed. McCabe and Sproul then made the five-minute drive to the Treasury to see Secretary Snyder.

Leach recalls hearing that when told that the Fed planned to raise short-term interest rates, Secretary Snyder reacted angrily. He immediately announced the refunding of the 13-month Treasury issues maturing not only in September but also in October. He rolled them both into 13-month notes at the pegged rate of 1 1/4 percent. Snyder assumed, incorrectly as it turned out, that his action would force the Fed into maintaining the old pegged rate. Dealers immediately understood the implications of the Desk's par bid for the new Treasury issue. At the opening of the market on Monday, they dropped their offering prices (raising rates) on other short-term issues. In the next few days, several billion dollars in securities traded at the higher rates (and at the corresponding lower prices).

At the beginning of the August 1950 FOMC meeting, Governor Eccles had argued that the Fed could act only with Treasury acquiescence. During the lunch break, other staff members and Leach explained to him that buying the new issue at par would soften the challenge to the Treasury. When the meeting resumed, Eccles argued that the proposed action would be a good way to get the debate into the open. As Thomas told Leach after the meeting, "We walked him [Eccles] up one side of Constitution Avenue and down the other, and it turned out well." But Thomas also said that Eccles wanted to see Leach in his private office. There, Eccles gave Leach quite a dressing down for having been too forward at the meeting.

Newspapers were full of stories of the Fed challenge to the Treasury. Fed critics claimed that the Fed had taken over management of the federal debt. Fed supporters countered that the Treasury should price its offerings at interest rates that would attract investors to buy and hold them.

At the September 27, 1950, meeting of the Executive Committee, Allan Sproul, associate economist John Williams, and Board economist Winfield Riefiler argued for another rise in short-term rates.¹⁰ Marriner Eccles demurred.

¹⁰ Sproul valued highly his conversations with John H. Williams. Williams was both an officer of the New York Bank and a professor at Harvard. (He trained many of the next generation of Fed policymakers.) He was a renowned expert in international finance and became President of the American Economic Association in 1952. Williams (FOMC Minutes, 8/18/50, p. 144) said at the August 1950 FOMC meeting that "[T]he basic question was how far the committee would be willing to see interest rates rise in order to curb monetary inflation and everything else would be ineffective unless there was a rise in interest rates."

He argued that no significant increase in short-term rates would be possible without an increase in the long-term rate. Before that could happen, Eccles said, the Fed would need to “present the matter to Congress with a clear explanation of the problems and the alternatives available” (FOMC Minutes, 9/27/50, p. 167). At the time, the success of General Douglas MacArthur’s September 15 Inchon landing, 200 miles behind enemy lines, must have made the viability of the 2 1/2 bond rate peg appear less problematic. If the troops were home by Christmas, the Treasury would not have to issue new debt.

At its meeting on October 11, the FOMC gave the Executive Committee authority to raise the one-year Treasury bill rate. The Executive Committee raised the rate to 1 1/2 percent despite “the strong feeling of the Secretary of the Treasury that the action should not be taken (FOMC Minutes, 10/11/50, p. 197). On October 16, the Board of Governors sent a letter to Secretary Snyder explaining its actions. It stated, “We can assure you that these actions will not affect the maintenance of the 2 1/2 percent rate for the outstanding long-term government bonds” (FOMC Minutes, 10/11/50, p. 209).

Within the FOMC, President Truman had an ally who used newspaper leaks to discredit Chairman McCabe. Newspapers like the *American Banker* presented accounts of confidential System meetings that derived from an insider. Those leaked versions incorrectly portrayed FOMC participants as divided in their challenge to the Treasury. Suspicion focused on Governor James K. (Jake) Vardaman, who had been a close friend of President Truman from the latter’s early days as a politician in Kansas City, Missouri. Truman had appointed him to the Board in 1946.

Leach recalls that at a Board meeting in fall 1950, Board Vice Chairman M. S. (Matt) Szymczak declared that the leaks were disgraceful and that he was not responsible for them. One by one, the governors repeated Governor Szymczak’s statement. Vardaman could see the sentiment moving around the table toward him. Before it reached him, he rose from the table and left the room stating, “I don’t have to put up with this.”

Throughout the fall, FOMC Chairman McCabe and Vice Chairman Sproul attempted to persuade Treasury Secretary Snyder directly and, indirectly through him, President Truman of the need to raise interest rates. However, the chasm that existed was unbridgeable. Truman and Snyder were populists

Williams, like other Fed economists, tempered the Keynesian views of academia in response to postwar policy problems. Contrary to the expectations of Keynesians, the most important policy problem after the war was inflation rather than depression. The problem was not how to stimulate aggregate demand, but rather how to restrain it. In his presidential address to the American Economics Association, Williams (1952, p. 8) criticized Keynes. “Keynes’ emphasis on the demand side—his principle of effective demand—sins quite as much in its taking for granted the adaptability of supply as the classical economists did in their reverse emphasis. This has interested me particularly in connection with problems of international trade adjustment.” (The last comment refers to Williams’s consulting on the overvalued British pound.) Fed economists thus recognized the importance of monetary policy and its relation to inflation some 20 years before the economics profession began to debate seriously that possibility.

who believed that banks, not the market forces of supply and demand, set interest rates. Truman felt that government had a moral obligation to protect the market value of the war bonds purchased by patriotic citizens. He talked about how in World War I he had purchased Liberty Bonds, only to see their value fall after the war.¹¹

Although the Fed continued to try to convince the Treasury of the need for a rise in interest rates, it never considered unilateral abandonment of the 2 1/2 percent bond rate peg. However, and this was the sticking point, it would not publicly commit to the indefinite maintenance of the peg. The Treasury wanted the Fed to commit publicly to maintaining the existing interest rate structure for the duration of hostilities in Korea. In early December, President Truman telephoned Chairman McCabe at McCabe's home and urged him to "stick rigidly to the pegged rates on the longest bonds." McCabe replied that he "could not understand why we would. . . allow the life insurance companies to unload [their bonds] on us" (FOMC Minutes, 1/31/51, p. 9).

Truman followed up by writing McCabe:

[T]he Federal Reserve Board should make it perfectly plain. . . to the New York Bankers that the peg is stabilized. . . I hope the Board will. . . not allow the bottom to drop from under our securities. If that happens that is exactly what Mr. Stalin wants. (FOMC Minutes, 1/31/51, p. 9)

2. FROM STALEMATE TO CONFRONTATION

The formally correct but strained relationship between the Fed and the Treasury fell apart as the war in Korea intensified. On November 25 and 26, the Chinese army, 300 thousand strong, crossed the Yalu River. Suddenly, the United States faced the possibility of a war with China and, if the Soviet Union came to the aid of its ally, of World War III. As the communists pushed Allied forces back down the Korean peninsula, Washington wondered whether General MacArthur could stop the communist advance at the 38th parallel. MacArthur requested authority to involve the Nationalist troops of Chiang Kai-shek, and Truman at a press conference left the impression that MacArthur could use atomic weapons. Anticipating the reimposition of wartime controls and shortages, consumers rushed out to buy consumer durables. On world markets, commodity prices soared. For the three-month period ending February 1951, CPI inflation was at an annualized rate of 21 percent.

¹¹ Truman wrote Russell C. Leffingwell, Chairman of J. P. Morgan, "I can't understand why the bankers would want to upset the credit of the nation in the midst of a terrible national emergency. That seems to be what they want to do and if I can prevent it they are not going to do it" (Donovan 1982, p. 329). Snyder believed that "Sproul and New York bankers and brokers were trying to recapture the primacy in fiscal and monetary affairs that had been lost to Washington during the New Deal" (Donovan 1982, p. 328).

The working relationship between the Fed and the Treasury then began to unravel. The prospect of a prolonged war created the likelihood of government deficits and the issuance of new government debt. Additional debt would force down the price of debt unless the Fed monetized it. That is, to prevent yields from rising above the 2 1/2 percent rate peg, the Fed would have to buy debt and increase bank reserves. Banks would then fuel an inflationary expansion through increases in credit and the money supply.

At the November 27 FOMC meeting, Sproul argued that “[W]e must look toward unfreezing the long end of the rate pattern as well as the short end.” Eccles countered that the Fed should “present the matter to Congress and that the Congress should decide” (FOMC Minutes, 11/27/50, p. 236). However, he made an additional suggestion. Throughout 1950, the 2 1/2 percent ceiling on bond rates had not been binding. The New York Desk had kept the price of long-term bonds above par (their interest rate below to 2 1/2 percent), and the Desk still had to sell bonds. Eccles advocated that their price be allowed to fall somewhat so that they would trade just below 2 1/2 percent.

That fall in the bond price would still leave in place the sacrosanct 2 1/2 percent rate peg. However, it would address an immediate problem. The threat of a major, protracted war created the real possibility that the bond rate would rise to its 2 1/2 percent ceiling. Life insurance companies, which held the bonds, then had an incentive to sell them immediately to avoid a capital loss as bond prices declined.¹² The Fed did not want to monetize an avalanche of bond sales. For that reason, it wanted to eliminate the above-par price on the bonds. The Treasury, in contrast, saw the problem as one of the Fed’s own creation. If the Fed would only publicly commit to maintaining indefinitely the current price of bonds, it believed, bond holders would no longer have an incentive to sell.

These conflicting views collided over a routine Treasury refunding. On November 13, Secretary Snyder wrote Chairman McCabe requesting the FOMC’s views on the appropriate yields to offer on a December 15 refunding. The Treasury accepted the Fed’s advice and priced its issues in a way that reflected the Fed’s recent increase in short-term rates. However, the refunding went poorly. Snyder believed that the Fed had reneged on a pledge of full cooperation. Why?

During the time that elapsed between the pricing of the new issues and bringing them to market, the Chinese entered the war and routed American forces. For the reason given above, the FOMC then reduced slightly its buying price for long-term bonds. Secretary Snyder saw that action as creating a fear of capital loss that hindered the success of the refunding. On December 9, McCabe had written President Truman that the Fed would give its full

¹² Life insurance companies held the bonds; banks were prohibited from holding them.

support to the refunding; Snyder believed that the Fed had not honored that commitment.¹³

McCabe and Sproul met with Snyder on January 3, 1951. Sproul argued that the inflation following World War II had come from too low a rate peg. He accepted that the possibility of large future government deficits might necessitate maintaining a rate peg. However, in anticipation of that eventuality, the Fed should allow a higher level of the peg. He also added, "If present inflationary advances in the credit sector continue. . . further action to restrict the availability of bank reserves would be in order" (FOMC Minutes, 1/31/51, p. 5).

On January 17, 1951, McCabe met with Truman and Snyder at the White House. When he returned from the meeting, McCabe dictated a memorandum of the conversation (see FOMC Minutes, 1/31/51, pp. 12–13). At the meeting, he made the point that "the purchase of these bonds resulted in the creation of reserves in the banks, which were very inflationary." Truman and Snyder reiterated their desire for the Fed to make a public commitment to the 2 1/2 percent bond peg. Snyder argued that investors would stop selling their bonds if the Fed were to reassure them that it would maintain the price of bonds.

On January 18, Secretary Snyder addressed the New York Board of Trade. There he announced that Chairman McCabe had agreed that future Treasury "issues will be financed within the pattern of that [2 1/2 percent] rate" (U.S. Treasury 1951, p. 616). In his memoirs, Eccles (1951, p. 485) expressed his feelings by quoting commentary contained in the *New York Times*: "[L]ast Thursday constituted the first occasion in history on which the head of the Exchequer of a great nation had either the effrontery or the ineptitude, or both, to deliver a public address in which he has so far usurped the function of the central bank as to tell the country what kind of monetary policy it was going to be subjected to." When the FOMC met on January 31, McCabe told its members that he was "shocked to read the account of Snyder's speech" and that he had made no such commitment (FOMC Minutes, 1/31/51, p. 14).

Later, in a written response to questions from Representative Wright Patman (February 12, 1952), Secretary Snyder said that Chairman McCabe had "assured the president that he need not be concerned about the 2-1/2 percent long-term rate" (U.S. Treasury 1951, p. 270). During the Patman hearings over the Fed-Treasury relationship in March 1952, Senator Douglas failed to get a clarification from Secretary Snyder on exactly what McCabe had promised and declared, "Talleyrand said that words were used to conceal thought. I have always thought that words should be used to express thought, and it is the lack

¹³ The Treasury's version of the dispute appears in the reply to the Patman questionnaire by Treasury Secretary Snyder in U.S. Congress (1952a). The reply is also reprinted in U.S. Treasury (1951). The Fed's version is contained in Allan Sproul's (1952, p. 521) testimony in the Patman Hearings in U.S. Congress (1952b). Walker (1955) contains a readable summary.

of this quality which I find unsatisfactory in your testimony throughout” (U.S. Congress 1952b, p. 37).

Truman had compelling reasons to freeze interest rates. On January 25, 1951, he froze wages and prices, apart from farm prices. Raising the cost of borrowing, especially on home mortgages, while freezing wages was poison.¹⁴ More important, in January 1951 Truman confronted the possibility of world war. Treasury communication with the Fed referred to a possible Soviet attack on the United States “within the foreseeable future” (FOMC Minutes, 3/1/51, p. 119). Truman and Snyder wanted to keep down the cost of financing the deficits that would emerge from a wider war.

Truman and the leadership in Congress believed that deficit financing had caused the World War II inflation (Goodwin and Herren 1975, p. 70; Donovan 1982, p. 325). At the urging of the Administration, Congress raised taxes sharply in September 1950 with the Revenue Act of 1950 and again in January 1951 with an excess profits tax (Goodwin and Herren 1976, p. 71). However, if the war widened to include China and possibly the Soviet Union, there would be government deficits.

By early 1951, communist forces had recaptured Pyongyang and Seoul. In a cable to Washington, General MacArthur stated that the “military position is untenable, but it can hold for any length of time up to its complete destruction if overriding political considerations so dictate.”¹⁵ Secretary of State Acheson decided that the Eighth Army should withdraw from Korea if losses threatened its ability to defend Japan. A naval blockade of China that would provoke a wider war loomed as a possibility. Later, General Omar Bradley said, “[I]f we had been driven out, I think our people would have demanded something else be done against China.”

On January 25, Governor Eccles, speaking for himself, openly challenged the Administration in testimony before the Joint Committee on the Economic Report. He testified:

As long as the Federal Reserve is required to buy government securities at the will of the market for the purpose of defending a fixed pattern of interest rates established by the Treasury, it must stand ready to create new bank reserves in unlimited amount. This policy makes the entire banking system, through the action of the Federal Reserve System, an engine of inflation. (U.S. Congress 1951, p. 158)

Governor Eccles and Representative Wright Patman, who was a populist congressman from Texarkana, Texas, went head-to-head:

¹⁴ See, for example, the exchange between Governor Eccles and Senator Joseph C. O'Mahoney in U.S. Congress 1951, p. 181.

¹⁵ The material in this paragraph is from Donovan (1982, p. 346–48).

Patman: Don't you think there is some obligation of the Federal Reserve System to protect the public against excessive interest rates?

Eccles: I think there is a greater obligation to the American public to protect them against the deterioration of the dollar.

Patman: Who is master, the Federal Reserve or the Treasury? You know, the Treasury came here first.

Eccles: How do you reconcile the Treasury's position of saying they want the interest rate low, with the Federal Reserve standing ready to peg the market, and at the same time expect to stop inflation?

Patman: Will the Federal Reserve System support the Secretary of the Treasury in that effort [to retain the 2 1/2 percent rate] or will it refuse?...You are sabotaging the Treasury. I think it ought to be stopped.

Eccles: [E]ither the Federal Reserve should be recognized as having some independent status, or it should be considered as simply an agency or a bureau of the Treasury. (U.S. Congress 1951, pp. 172–76)

On January 29, in an open challenge to the Treasury, the Fed lowered the bond price (raised its yield) by 1/32. Although the bond yield remained just below 2 1/2 percent, that action prompted Snyder to ask Truman to call the entire FOMC to the White House (FOMC Minutes, 1/31/51, p. 20). It was the first time in history that any President had called the FOMC to meet with him.¹⁶ The FOMC met on January 31 and McCabe informed its members that they could either resign or agree to the President's demand to peg interest rates. Sproul suggested an additional alternative, namely to ask Congress to resolve the impasse (FOMC Minutes, 1/31/51, pp. 15–16, 19).

The FOMC then tried to prepare a statement for its meeting with the President. Governor Vardaman disagreed with the contents and stated that “in a period such as the present, the members of the Board ceased to be civilian officers of the government, and that he would be guided by whatever request was made by the President as Commander-in-Chief” (FOMC Minutes, 1/31/51, p. 21). Sproul replied that this “would make the Federal Reserve System a bureau of the Treasury and, in light of the responsibilities placed in the System by the Congress, would be both impossible and improper” (FOMC Minutes, 1/31/51, p. 23). The FOMC abandoned the attempt to draft a statement.

The FOMC met with President Truman late in the afternoon of Wednesday, January 31.¹⁷ Truman began by stating that “the present emergency is

¹⁶ Allan Sproul (1980) and Marriner Eccles (1951) have provided eyewitness accounts. (Stein [1990] and Walker [1955] provide a historical overview.)

¹⁷ See FOMC Minutes, 1/31/51, pp. 24–26, for the following account.

the greatest this country has ever faced, including the two World Wars and all the preceding wars... [W]e must combat Communist influence on many fronts... [I]f the people lose confidence in government securities all we hope to gain from our military mobilization, and war if need be, might be jeopardized." Chairman McCabe in turn explained the responsibility of the Federal Reserve "to promote stability in the economy by regulating the volume, cost and availability of money, keeping in mind at all times the best interests of the whole economy." McCabe suggested a continuing dialogue with Secretary Snyder, and, if that dialogue failed, a meeting between him and the President.

After meeting with the President, the FOMC reconvened and asked Governor Evans to prepare a memorandum recording the events of the meeting.¹⁸ Sproul reviewed it. The memorandum recorded that FOMC members had made no commitment to the President. Nonetheless, the next morning the White House press secretary issued a statement that "The Federal Reserve Board has pledged its support to President Truman to maintain the stability of Government securities as long as the emergency lasts." The Treasury then issued a statement saying that the White House announcement "means the market for Government securities will be stabilized at present levels and that these levels will be maintained during the present emergency."¹⁹

Eccles received telephone calls from Alfred Friendly of the *Washington Post* and Felix Belair, Jr., of the *New York Times*. Eccles contradicted the Administration's press releases by telling them that the FOMC had made no such commitment. Without attribution, the two newspapers reported Eccles's comments the next day. The following morning, Friday, members of the Executive Committee met informally at the request of Governor Vardaman.²⁰ Vardaman demanded to know who was the source of the *Times* story. Eccles said that he was the source and defended his release of the information.

The governors then had to decide how to respond to a letter that Chairman McCabe had just received from President Truman. The "Dear Tom" letter included the false statement, "I have your assurance that the market on government securities will be stabilized and maintained at present levels." After discussion, the FOMC agreed that McCabe should meet privately with President Truman to ask him to withdraw the letter. However, McCabe went to his house in Philadelphia for the weekend without seeing Truman.

Upon seeing the stories in the *Washington Post* and the *New York Times*, and without informing McCabe, Snyder had Truman release to the press his (Truman's) letter to McCabe. Later, in his memoirs, Eccles (1951, p. 494) recorded his reaction. "[T]he letter was the final move in a Treasury attempt to impose its will on the Federal Reserve. If swift action was not taken... the

¹⁸ The above quotes are from this memorandum.

¹⁹ This paragraph and the next three are from Eccles (1951, pp. 491–93).

²⁰ This account is from Eccles (1951, pp. 491–97) and Hyman (1976, pp. 349–51).

Federal Reserve would...lose the independent status Congress meant it to have and...would be reduced to the level of a Treasury bureau.”

Eccles also reported in his memoirs that shortly before this event he had completed a letter of resignation to the President. He then decided to postpone his resignation. Eccles had been Chairman of the FOMC from its creation in 1935 until 1948. He did not intend to leave Washington with the Federal Reserve under the control of the Treasury. According to a Truman staff member, Truman had failed to reappoint Eccles as Board Chairman in 1948 to show him “who’s boss” (Donovan 1982, p. 331). Eccles’s feeling that Truman had treated him peremptorily must have still rankled.

Belair of the *New York Times* telephoned Eccles (1951, p. 494) and informed him of the release of Truman’s letter. Eccles then made a momentous decision. Acting on his own, he released a copy of the memorandum written to record the FOMC’s account of the meeting with President Truman. Eccles arranged for it to appear in the Sunday, February 4, edition not only of the *New York Times*, but also of the *Washington Post* and the *Washington Evening Star*. The memorandum was headline news. As Eccles (1951, p. 496) put it, “[T]he fat was in the fire.” Hyman (1976, p. 349) wrote, “By Monday morning the controversy had reached blast furnace heat.”

Tuesday, February 6, Chairman McCabe convened meetings first of the Board and then of the FOMC to decide what to do.²¹ Governor Vardaman had written a statement asserting that “McCabe had given President Truman every reason to believe that the Committee and Board would support the government financing program.” Thwarted by Governor Powell in his attempt to send that statement out as a press release, Vardaman demanded a meeting of the Board unless he “wished to assume responsibility for throttling another member of the Board” (Board Minutes, 2/6/51, p. 254). At the Board meeting, McCabe accused Vardaman of leaking an account of the FOMC executive session after the White House meeting to a newspaper reporter, Doris Fleenon. Vardaman denied that he was the source of the leak, and Governor Evans asked “to have the minutes show that he did not believe Mr. Vardaman’s statement” (Board Minutes, 2/6/51, p. 257). Governor Szymczak said that President Truman must have signed the letter to McCabe without having seen it, and Governor Vardaman said that he “did not intend to discuss the veracity of the President” (Board Minutes, 2/6/51, p. 259).

When the FOMC met, it discussed writing a letter to the President that would reestablish a working relationship with the executive branch. However, as pointed out by Governor Vardaman, “[T]he suggestions made by Mr. Sproul did not contemplate any change in the policy of the committee, that was the crux of the matter” (FOMC Minutes, 2/6/51, p. 45). Led by Sproul and Eccles,

²¹ This paragraph draws on Board Minutes (1951, pp. 254–59).

the FOMC was unwilling to make a long-term commitment to peg the price of government bonds at 2 1/2 percent.

Forced by the rate peg issue to make a stand on the role of a central bank in creating inflation, Eccles expressed the nature of a central bank in a fiat money regime. It was not private speculation or government deficits that caused inflation, but rather reserves and money creation by the central bank. Eccles said:

[We are making] it possible for the public to convert Government securities into money to expand the money supply... We are almost solely responsible for this inflation. It is not deficit financing that is responsible because there has been surplus in the Treasury right along; the whole question of having rationing and price controls is due to the fact that we have this monetary inflation, and this committee is the only agency in existence that can curb and stop the growth of money... [W]e should tell the Treasury, the President, and the Congress these facts, and do something about it... We have not only the power but the responsibility... If Congress does not like what we are doing, then they can change the rules. (FOMC Minutes, 2/6/51, pp. 50–51)

And in fact at the next FOMC meeting, Sproul would state the idea that a central bank controls inflation through the monetary control made possible by allowing market determination of the interest rate:

[T]he Committee did not in its operations drive securities to any price or yield... [M]arket forces had been the determining factor, and that only in resisting the creation of reserves had the committee been a party to an increase in interest rates. That... was the result of market forces, and not the action of the Committee. (FOMC Minutes, 3/1/51, pp. 125–26)

In a letter that accepted the responsibility of the Fed for inflation, the FOMC wrote to Truman:

We favor the lowest rate of interest on government securities that will cause true investors to buy and hold these securities. Today's inflation... is due to mounting civilian expenditures largely financed directly or indirectly by sale of Government securities to the Federal Reserve... The inevitable result is more and more money and cheaper and cheaper dollars. (FOMC Minutes, 2/7/51, p. 60)

The white-hot crucible of debate over the consequences of interest rate pegging marked an intellectual watershed. Gone was the self-image of a central bank that allows an “elastic currency” passively to “accommodate commerce” (see Humphrey [2001]). The Fed moved toward the idea of the control of money creation to stabilize the purchasing power of the dollar.

The FOMC's February 7 letter to President Truman contained its offer to work with the Secretary of the Treasury. The FOMC also wrote a letter to the Secretary making a number of specific proposals. McCabe ended the February 7 meeting by referring to a *Wall Street Journal* article purporting that the discussion in the previous FOMC meeting had been "acrimonious"; also, several senators had informed McCabe that a Board member was "undermining with members of Congress" the FOMC's position (FOMC Minutes, 2/7/51, p. 66). (The leaks undermined the position of the Chairman by claiming that his views did not reflect the views of the Committee.) McCabe threatened dismissal for any FOMC member leaking confidential discussion to the press or Congress.

On February 8, McCabe and Sproul then met with Secretary Snyder. It was their first meeting since the February 4 newspaper stories contradicting the White House statement that the Fed had committed itself to maintaining the peg. McCabe recounted it that afternoon for the FOMC (FOMC Minutes, 2/8/51, pp. 67–68). Snyder "had very strong feelings about the situation that had been created." He claimed that McCabe had not followed through on his [Snyder's] "understandings" of the January 17 meeting with the President. When McCabe read the letter the FOMC had written to the President, Snyder called it "preachy."

McCabe continued:

I also said that if the Secretary had in mind making a public announcement like the one he made on January 18, I felt strongly that he should have let me know, especially where he used my name and the President's name...I said to the Secretary, "The President told me afterward that he did not know you were going to make a speech in New York." That disturbed Secretary Snyder very greatly. He said the President knew exactly what he was going to say...I said this had cut me very deeply. (FOMC Minutes, 2/8/51, p. 68)

During its afternoon meeting, the FOMC learned that the President had said at a news conference that "it was his understanding that a majority of the Reserve Board members sided with him on the interest rate question between the Board and the Treasury" (FOMC Minutes, 2/8/51, p. 70).

The Executive Committee met on Wednesday February 14. At the meeting, McCabe told the Committee how political pressure had converged on the Fed from both the executive and legislative branches of government. Secretary Snyder had announced on Saturday, February 10, that he was going into the hospital on Sunday. (His doctor had advised him to have a cataract operation.) McCabe called Snyder, who urged him to do nothing for the two weeks he expected to be in the hospital. Snyder then called Senator Maybank.

Senators Maybank (D. South Carolina), Robertson (D. Virginia), and O'Mahoney (D. Wyoming) called McCabe (FOMC Minutes, 2/14/51, p. 79).

All three were members of the Committee on Banking and Currency and O'Mahoney was Chairman of the Joint Committee on the Economic Report. O'Mahoney told McCabe that Representative Patman and Senator Capehart (R. Indiana) wanted to hold hearings that would be critical of the Fed. Maybank, Robertson, and O'Mahoney supported Snyder's advice to withdraw the FOMC's letter to the President. McCabe told the FOMC, "It was evident from my conversations with the Senators that they were fearful of publicity of our letter to the President and of public hearings" (FOMC Minutes, 2/14/51, pp. 80–81). The senators urged the Fed to do nothing while Snyder was in the hospital (Sproul 1952, p. 522).

To emphasize his point that the Fed should not openly confront the executive branch, O'Mahoney sent McCabe a letter stating:

The Soviet dictators are convinced that the capitalistic world will wreck itself by economic collapse arising from the inability or unwillingness of different segments of the population to unite upon economic policy. Inflation in the United States is the result of no single cause and therefore cannot be remedied by a single cure.... It is imperative in this crisis that there should be no conflict between the Federal Reserve Board and the Treasury. (FOMC Minutes, 2/14/51, p. 83)

The banking community contributed to the Fed's isolation by refusing to support its position. On February 2, the Board had met with the Federal Advisory Council, which represents the views of large banks. At that meeting, Eccles accused bankers of a lack of "courage and realistic leadership" (Board Minutes, 2/20/51, p. 389).

The Executive Committee refused to withdraw the FOMC's letter to the President. Furthermore, it wrote a defiant letter to Senator O'Mahoney. The initial substantive paragraph began with the famous quote from John Maynard Keynes: "[T]hat the best way to destroy the Capitalist System was to debauch the currency" (FOMC Minutes, 2/14/51, p. 87). The letter expressed hope for an agreement with the Treasury, but ended by saying that if such agreement were not possible "[W]e will have no defensible alternative but to do what, in our considered judgment, is for the best interests of the country, in accordance with our statutory responsibilities" (FOMC Minutes, 2/14/51, p. 89).

The Fed then forced resolution of the dispute. It informed the Treasury that as of February 19, it "was no longer willing to maintain the existing situation in the Government security market" (U.S. Treasury 1951, p. 266). Sproul (1952, p. 522) recounted that the Fed informed the Treasury that "unless there was someone at the Treasury who could work out a prompt and definitive agreement with us... we would have to take unilateral action." At the time, the Treasury faced a sizable need to refund existing debt. For the first time, it also faced the prospect of issuing new debt. To quiet uncertainty in the

markets, the Treasury believed it had no choice but to end the public dispute (U.S. Treasury 1951, p. 270).

On the morning of February 26, McCabe and Sproul attended a meeting in the White House with the President and other government policymakers. (Snyder remained in the hospital.) Truman read a memorandum stating that “Changing the interest rate is only one of several methods to be considered for curbing credit expansion.” He then asked the Fed chairman and other policymakers “to study ways and means to provide the necessary restraint on private credit expansion and at the same time to make it possible to maintain stability in the market for government securities” (FOMC Minutes, 2/26/51, p. 102). As an alternative to a rise in interest rates, Truman asked for selective credit controls (“direct Government controls”) to limit credit extension (FOMC Minutes, 2/26/51, p. 102). When Chairman McCabe “commented on the situation created by the continued purchase by the System of . . . bonds,” Treasury Under Secretary Foley countered “that the proposed action by the Federal Open Market Committee might cause a crisis which should be avoided.” While the meeting was underway, the White House released the contents of the President’s memorandum to the press.

The Treasury maintained the position that direct controls on credit were preferable to increases in interest rates (FOMC Minutes, 3/1/51, p. 117). However, the Treasury also believed that an end to the dispute with the Fed would restore market confidence and allow it to continue to sell bonds at 2 1/2 percent (FOMC Minutes, 3/3/51, p. 153). Moreover, as became apparent later, the Treasury still had another weapon to use.

When Snyder went into the hospital, he left negotiations with the Fed in the hands of the Assistant Secretary of the Treasury, William McChesney Martin.²² Martin notified the Fed that he desired negotiations based on the FOMC’s February 7 letter. He reestablished staff contact between the Treasury and the Fed, which Snyder, as Leach recalls, had forbidden some years earlier. William McChesney Martin and Fed staff members Robert Rouse, Woodlief Thomas, and especially Winfield Riefler, negotiated an agreement between the Treasury and the Fed (FOMC Minutes, 2/26/51, p. 93; FOMC Minutes, 3/1/51, pp. 112–13).

As presented to the FOMC on March 1, the resulting agreement reflected Riefler’s original ideas. The Fed would keep the discount rate at 1 3/4 percent through the end of 1951. The Treasury would remove marketable bonds from the market by exchanging them for a nonmarketable bond yielding 2 3/4

²² Martin had exceptional qualifications. In 1938, at age 31, he became president of the New York Stock Exchange. Newspapers called him the “boy wonder of Wall Street.” After the Army drafted him in World War II, he helped run the Russian lend-lease program. In 1946, he became head of the Export-Import Bank. In December 1948, Treasury Secretary Snyder, a fellow Missourian, convinced Martin to join the Treasury. Finally, Martin’s father had been Governor of the Federal Reserve Bank of Saint Louis.

percent.²³ To make those bonds liquid and thus more attractive to the market, the Treasury would exchange them upon request for a 1 1/2 percent marketable five-year note. During the exchange, the Fed would support the price of the five-year notes. That support was central because the value of the nonmarketable bonds depended upon the price of the five-year note. However, the Fed made no commitment to support the note's price beyond purchases of \$200 million.

On March 1, Martin presented the compromise to the FOMC. The minutes make clear that he displayed the charm for which he is legendary. He began by saying, "I want to say for the Treasury people we could not have had pleasanter or more frank or more open discussions" (FOMC Minutes, 3/1/51, p. 118). The main sticking point for the FOMC was whether the Treasury had accepted, during the bond exchange, a limitation both on the duration and dollar amount of its intervention in support of the five-year note (FOMC Minutes, 3/1/51, p. 136). Also, the FOMC wanted to make sure that its commitment to maintain "orderly markets" did not imply a rate peg.

The FOMC met again on March 3, 1951. Chairman McCabe said that Mr. Murphy, Special Counsel to the President, had inquired on behalf of President Truman whether long-term bonds would drop below par. McCabe had replied to Murphy that he could not say. During the meeting, Riefler received a telephone call from Martin informing him that Secretary Snyder, who was still in the hospital, had accepted limitations on Fed support during the exchange of the marketable for the nonmarketable bonds. However, Martin requested that there be no written record of that point (FOMC Minutes, 3/3/51, p. 158).

The FOMC then voted to ratify the Accord and to issue the following statement the next day: "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" (FOMC Minutes, 3/3/51, pp. 156, 163).

The Administration had one more hope that it would prevail.²⁴ While in the hospital, Snyder conveyed to Truman the message that he felt he could no longer work with McCabe. Without a working relationship with the Treasury, McCabe could not function as Chairman of the Board of Governors. McCabe sent in a bitter letter of resignation, but resubmitted a bland version when asked to do so by the White House. McCabe, however, conditioned his resignation on the requirement that his successor be acceptable to the Fed. On March 15,

²³ About \$40 billion in 2 1/2 percent bonds were outstanding (U.S. Treasury, *1950 Annual Report*, Table 17).

²⁴ Donovan (1982, p. 328) wrote, "Truman forced McCabe out as chairman of the Board of Governors." This paragraph summarizes Donovan (1982, p. 331).

the President appointed William McChesney Martin to replace McCabe. The Senate confirmed Martin on March 21. McCabe left office on March 31, and Martin took office April 2.

Leach recalls that the initial reaction both among Board staff and on Wall Street to Martin's appointment was that the Fed had won the battle but lost the war. That is, the Fed had broken free from the Treasury, but then the Treasury had recaptured it by installing its own man. However, as FOMC Chairman, Martin supported Fed independence. Some years later, Martin happened to encounter Harry Truman on a street in New York City. Truman stared at him, said one word, "traitor," and then continued.²⁵ Leon Keyserling (1971, p. 11), chairman of the Council of Economic Advisers from 1950 through 1952, said later: "[Truman] was as strong as any President had ever been in recognizing the evils of tight money... He sent Martin over to the Treasury to replace McCabe. Martin promptly double-crossed him."

In his speech accepting an appointment to the Board of Governors, Martin (1951, p. 377) said:

Unless inflation is controlled, it could prove to be an even more serious threat to the vitality of our country than the more spectacular aggressions of enemies outside our borders. I pledge myself to support all reasonable measures to preserve the purchasing power of the dollar.

The Treasury's offering of the new 2 3/4 percent nonmarketable notes in exchange for the 2 1/2 percent marketable issues took place from March 26 through April 6. During this period, as provided for in the Accord, the Fed purchased the five-year notes as needed to support their price. However, the Fed spent the entire amount agreed to in the first three days. "[D]ismayed Treasury officials asked for continued support. The request was refused, and there was nothing more the Treasury could do about the matter" (Hyman 1976, p. 351). The Fed just said "No." Thereafter, the Fed bought only small amounts of the bonds to prevent "disorderly conditions in the market." Their price went from around 100 3/4 before the Accord to around 97 in the last half of the year "when the bond market was on its own" (Board *1951 Annual Report*, p. 5).

Under its new leadership, the FOMC had issued its ultimate challenge to the White House. Why did Truman finally walk away from the conflict? For Truman to triumph over the Fed, he would have had to prevail in Congress; however, his precarious political position in early April 1951 made that impossible. Truman's political popularity had plummeted in part because of scandal. Earlier that year, Senator Fulbright (D. Arkansas) had released a report

²⁵ Telephone interview, Robert Mayo, April 10, 1998.

accusing two directors of the Reconstruction Finance Corporation (RFC), one a politically well-connected Democrat, of favoritism (Donovan 1982, p. 333).

More important, shortly after the conclusion of the Accord, a much more serious and long-simmering crisis boiled over: the tension between President Truman and General Douglas MacArthur. MacArthur had opposed Truman's policy of limited war, saying that it amounted to "surrender." Truman had made the decision to seek peace in Korea through its partition at the 38th parallel rather than to engage China in a wider war, which he feared would involve the Soviet Union and atomic weapons. On February 13, MacArthur called Truman's policy "unrealistic and illusory."²⁶

On March 24, MacArthur claimed that he could defeat China if only Washington would stop restricting him militarily. He even offered "to confer in the field with the commander-in-chief of the enemy forces." His statements sabotaged secret negotiations to settle the war. Representative Joseph (Joe) Martin (R. Mass.) advocated the use of Chiang Kai-shek's forces in Formosa to open a second front against China. MacArthur supported Martin in a letter, which included the phrase "There is no substitute for victory" (Donovan 1982, p. 352). On April 5, Martin read MacArthur's letter in the House of Representatives.

On April 10, four days after the end of the bond exchange, Truman fired MacArthur. Truman biographer Robert Donovan (1982, p. 358) wrote that Truman "knew well enough that he would awake in a political climate raised to a pitch of hatred and recrimination so severe that it could not fail to stain the remainder of his term in office. Of all the storms he lived through as President, the one about to break was the worst." To aggravate Truman's problems, MacArthur learned from the radio that Truman had fired him. The *Chicago Tribune* wrote in a front page editorial: "Truman must be impeached and convicted... [H]e is unfit, morally and mentally, for his high office" (Donovan 1982, p. 359).

Subsequent events gave the Fed time to incubate its fragile independence. Inflation abated sharply. CPI inflation averaged just over 3 percent from 1951Q2 through 1951Q4 and just less than 1.5 percent in 1952. Also, Dwight D. Eisenhower, Truman's successor and President from 1953 through 1960, and his Treasury secretaries shared the Fed's goal of price stability (Saulnier 1991).

3. CONCLUDING COMMENT

The March 1951 Accord marked the start of the modern Federal Reserve System. Under Chairman Martin, the Fed's overriding goals became price stability and macroeconomic stability.

²⁶ This paragraph and the next are from Donovan (1982, pp. 349–51).

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