REVIEW OF ANNUAL REPORT OF THE FEDERAL RESERVE SYSTEM FOR THE YEAR 1960

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

EIGHTY-SEVENTH CONGRESS

FIRST SESSION

PURSUANT TO

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REVIEW OF ANNUAL REPORT OF THE FEDERAL RESERVE SYSTEM FOR THE YEAR 1960

THURSDAY, JUNE 1, 1961

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The joint committee met, pursuant to notice, at 10 a.m., in room 1310, New House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, Griffiths, Widnall; Senators Sparkman, Pell, and Bush.

Also present: William Summers Johnson, executive director; and John W. Lehman, deputy executive director and clerk.

Chairman PATMAN. The committee will come to order.

These hearings are concerned with the recent policies and actions of the Federal Reserve System of the type which affect levels of employment, production, and purchasing power.

We would like to review particularly the record of such actions as it is set out in the annual report of the Board of Governors for the calendar year 1960.

In keeping with the spirit of the Employment Act of 1946, which is to preserve and strengthen our free competitive enterprise, it is customary for the Federal Government to exert its main influences on the economy only through very general monetary and fiscal policies.

The Employment Act requires the President to submit, at least once a year, an economic report which sets forth, among other things, a review of the economic programs of the Federal Government and their effects upon the levels of employment, production, and purchasing power during the preceding year; an estimate of current and foreseeable trends in such levels; and a program for achieving maximum employment, production, and purchasing power in the year ahead.

Thus it is customary for the Federal Government's fiscal policies to be stated in advance. On or about the time the Economic Report is submitted, the President submits his budget, setting out both spending and revenue expectations, as well as proposed changes in the tax system, if any.

Monetary policies are not, however, announced in advance. And while one of the monetary bodies announces its monetary decisions currently, at the time the decision is reached, a second body deciding monetary policy does not announce its decisions until long after the fact, indeed not until the Board submits its annual report for the year past.

Specifically, decisions made by the Board of Governors to raise or lower the discount rate, to raise or lower reserve requirements for the member banks, to raise or lower margin requirements for the purchase and holding of registered stocks, are all announced at the time these decisions are reached.

On the other hand, decisions made by the Federal Open Market Committee, decisions which also determine the cost and availability of money and credit, are not made public until the Board's annual report is made public.

These policy decisions of the Federal Open Market Committee are in the form, as I understand it, of directives to the Federal Reserve Bank of New York or possibly to the manager of the System account, which is located in the Federal Reserve Bank of New York.

The Federal Reserve Act (sec. 10, para. 10) requires that the Board:

> * * * shall keep a complete record of the action taken by the Board and by the Federal Open Market Committee upon all questions of policy relating to open-market operations and shall record therein the votes taken in connection with the determination of open-market policies and the reasons underlying the action of the Board and the Committtee in each instance.

It is the record of these actions and policy decisions, their meaning, and the reasons therefor, that the Committee will particularly wish to review.

To begin, we have with us this morning Mr. Robert G. Rouse, who is manager of the System account.

Mr. Rouse, we are happy to have you. Do you have a statement which you wish to read, or to file for the record, or would you like for us to begin our questioning?

STATEMENT OF ROBERT G. ROUSE, MANAGER, FEDERAL RESERVE SYSTEM'S OPEN MARKET ACCOUNT, ACCOMPANIED BY SPENCER S. MARSH, JR., ASSISTANT VICE PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK; AND ROBERT STONE, MANAGER, FEDERAL RESERVE BANK OF NEW YORK

Mr. Rouse. Mr. Chairman, I have a statement which might serve as a refresher to reacquaint you with things that I think you already know, but may not have had an opportunity——

Chairman Patman. You may proceed as you desire, sir.

Mr. Rouse. I also have with me my associates, Mr. Spencer S. Marsh, Jr.——

Chairman Patman. Identify them for the record, please.

Mr. Rouse. Mr. Spencer, S. Marsh, Jr., assistant vice president of the bank; Mr. Robert Stone, who is a manager of the bank, both of whom are assigned to the securities department.

Chairman Patman. Yes, sir. We are glad to have them.

Mr. Rouse. My name is Robert G. Rouse. I am manager of the Federal Reserve System's Open Market Account, and I am also a vice president of the Federal Reserve Bank of New York. You have asked me to appear before you as a witness in this hearing, which, I understand, is to focus mainly on questions suggested by the record of policy actions of the Federal Open Market Committee contained in the

Annual Report of the Board of Governors of the Federal Reserve System covering operations for the year 1960.

Before turning to a description of the process by which the policies established by the Federal Open Market Committee are translated into action by the management of the System open market account at the Federal Reserve Bank of New York, it might be of interest to the Joint Economic Committee to hear about one or two of the special developments in the Government securities market since my last testimony before your committee in August 1959. First of all, I am pleased to report that the program for regular statistical reporting by the Government securities dealers that arose out of the Treasury-Federal Reserve study of the Government securities market, and which was encouraged by your committee, has become a reality, with publication of the first data at the end of March. The collection and dissemination of these statistics is now working quite smoothly. Many of the dealers, despite some initial doubts, are finding that the statistics are useful to them. The general public interest in these statistics is illustrated by the fact that we have had requests from about 1,400 individuals and organizations to be put on the regular mailing list to receive them. I am also pleased to report that there has been an addition of one firm to the number of Government securities dealers with which the desk does business. This brings the total number of such dealers to 18, and there are good prospects that we may see two more organizations develop into full-fledged Government securities dealers in the near future. As I indicated to you in 1959, we welcome additions to the list of primary dealers; we hope that there will be more in the future.

I should also like to compliment your committee on the excellent study prepared under the direction of its staff and written by Professors Meltzer and von der Linde of Carnegie Institute of Technology. This study was a significant contribution to public knowledge of the Government securities market.

Much of what I have to say regarding the implementation of the policies of the Federal Open Market Committee is probably already familiar to you, since a great deal has already been written and said on this subject. In his appearance before the Joint Economic Commitee in December 1956, Mr. Hayes, president of the Federal Reserve Bank of New York, described in some detail how the Federal Open Market Committee reaches its policy decisions and how these decisions are implemented by the Federal Reserve Bank of New York; and my own statement at that time also commented on the role of the manager of the account in this respect. In addition, there is the booklet prepared by Robert Roosa, entitled "Federal Reserve Operations in the Money and Government Securities Markets," which has been widely circulated among the public.

I think there are some 90-odd-thousand of those books in circulation, and there was a substantial demand for them currently, in the current year.

This booklet was prepared by Mr. Roosa while he was associated with me in the management of the account as assistant vice president in the securities department of the New York bank. We believe it important that the interested public know as much as may properly be disclosed of how the System operates in the money and Govern-

ment securities markets. Despite the fact that there is much that is already known, I thought it might be of some interest to the committee to review briefly my personal experience as an individual in the front line of System operations that are designed to carry out System policies.

Open market policy is determined by the Federal Open Market Committee, which meets regularly at approximately 3-week intervals in Washington. These determinations are based on a broad and careful analysis of all aspects of the current state of business, credit conditions, international developments, and related matters. The Federal Reserve Bank of New York has been designated by the Committee as the institution in the System that conducts actual operations, on behalf of all 12 Federal Reserve banks, to put the Federal Open Market Committee's policy into operation.

As manager of the System open market account, it is my responsibility to supervise the execution of all open market transactions carried on in accordance with the Committee's policy decisions. In view of my position as manager of the System account, I attend the meetings of the Open Market Committee. At each of these meetings, I make a report of System operations and stand prepared to answer any questions that any member of the Committee may care to raise on the manner in which the Committee's directives have been carried out. My attendance at the meetings gives me an opportunity to hear at first hand what the Federal Open Market Committee has in mind as to policy for the succeeding period as developed in the meeting. As you know from the record of policy actions contained in the annual report of the Board of Governors, the Federal Open Market Committee at each meeting issues a directive to the Federal Reserve Bank of New York setting forth the Committee's policy in broad terms. In addition, the Committee arrives at a consensus during the course of each meeting, which tends to specify in somewhat more concrete terms, but still in a relatively general way, a series of guidelines for the manager of the account. It is my duty as manager of the account to make sure that the intentions of the Federal Open Market Committee as to the management of the account during the period between meetings of the Federal Open Market Committee are clear to me. My presence at those meetings affords me an opportunity of raising any questions that I may have at that time. In addition to the directive and the consensus laid down by the Committee, I have the benefit of hearing all the detailed statements by the several members of the Committee and by the other presidents of the Reserve banks who are not currently serving on the Committee. The views expressed in these statements serve as an important supplement to the more formal statement of the directive and the consensus, and sometimes furnish a number of additional guidelines for day-to-day operations.

A great deal remains to be said about the process by which day-to-day decisions to buy or sell Government securities are made on the basis of the Committee's policy intentions, and about the process by which the day-to-day activity of the account is reviewed by the Committee on a current basis. I hope that in trying to be brief, I will not leave out any essential elements of the story, and I shall, of course, be glad to answer any questions to fill in any gaps that you may feel exist in it.

First of all, it should be remembered that the Committee's decisions do not take place in a vacuum, but are made against the background of recent experience in the money and credit markets. I should like to emphasize this ever-present element of continuity. Quite often policy can be summarized in terms of creating somewhat more or somewhat less pressure in the money market and on member bank reserve positions, or in terms of maintaining about the same conditions that prevailed in an earlier period. In moving from a policy decision to day-to-day operations, the first question for determination is the effect of the natural influences in the market on bank reserves and on the degree of tightness or ease in the money markets. It may be, for example, that in the period immediately ahead, float, or a return flow of currency from circulation, or an inflow of gold, may be reasonably counted on to supply reserves to the market. If the Committee has decided upon a policy of ease, this natural flow of funds through the market may do a great part of the manager's job for him. If, on the other hand, the Committee is pursuing a policy of restraint, an increase in bank reserves through such natural factors will require offsetting operations and thus will tend to make the manager's problem more complicated.

In order to keep abreast of the very latest developments in all the factors affecting member bank reserve positions and the money market, the Federal Reserve has developed an elaborate system for collecting information, designed to feed into the manager's hands all the latest data pertaining to bank reserve positions and the various factors that may be affecting these positions. On each morning, for example, we have on hand a complete nationwide picture of the reserve positions of member banks as of the close of business the night before, including full information on the distribution of reserves as between the money market banks, reserve city banks, and country banks. In addition to up-to-the-minute information on past developments, we have a number of specialists who forecast changes in factors affecting bank reserves for the period immediately ahead. These estimates are revised each day for the next succeeding 3- or 4-week period.

But it is clear that cold statistics do not provide sufficient basis for the conduct of day-to-day operations. We also rely heavily on the specialists who work on our trading desk, which serves as the listening post of the Federal Reserve System on the Nation's money and securities markets. Located as we are in the heart of the country's financial center, and with direct communication with the Government securities dealers and the money market banks, we have a unique opportunity to follow developments in the market as they are occurring.

Part of our job is to disseminate this information on current developments throughout the System, and to the Treasury, for which we execute transactions as fiscal agent of the United States. But in addition, hour-by-hour developments, particularly those in the Federal funds market, in the Government securities market, in the progress of Government securities dealers in finding the financing required to carry their portfolios of Government securities, provide the manager of the account with information which gives him an informed judgment of the degree of ease or tightness in the market—

sometimes referred to as the "feel" of the market. The Federal funds rate tells us something about the availability of excess reserves in the banking system, with a rising rate indicative of somewhat greater pressure and a falling rate indicative of declining pressure on bank reserve positions. Similarly, if Government securities dealers—who scour the country each day in search of funds from banks, corporations, and State and municipal bodies—are having an easy time finding funds to finance their portfolios at relatively low rates, we know that there is a ready availability of short-term funds throughout the country. Movements in Treasury bill rates, too, may at times be indicative of nonbank liquidity as well as bank liquidity, and may be an important part of the information we use in reaching decisions on operations. Current trends in the capital markets are also taken into consideration in viewing the mix of pertinent factors.

The manager of the account is also directly concerned with activity by foreign central banks, monetary authorities and international institutions in our money market. Developments in our balance of payments and in the international position of the dollar are of course taken into consideration by the Federal Open Market Committee in its policy deliberations. But as vice president in charge of the securities department of the New York bank, I have a direct and immediate technical interest in these operations, since foreign central banks hold and invest so large a part of their dollar reserves through the Federal Reserve Bank of New York. Transactions for foreign accounts affect member bank reserves and thus must be taken into account when operations for System account are being considered. The gold outflow in 1960, for example, was one of the major factors affecting member bank reserves with which we had to deal. The fact that the Federal Reserve Bank of New York has close institutional relationships with foreign central banks and performs so large a percentage of transactions for their account in the money market enables us to have first hand information concerning the timing and the potential market impact of these transactions. At times the coordination of these foreign operations in the Government securities market with Federal Reserve open market operations can become a particularly important undertaking. Transactions for foreign accounts in the market on occasion may make the job of the manager of the System account somewhat easier; on other occasions, they may complicate it. At times, for example, it is possible for us to avoid an undesirable market impact of foreign account transactions by arranging transactions among these accounts or directly with the System open market account. In any event, the fact that we have knowledge of such foreign transactions permits us to integrate them with System account operations.

To sum up, then, we start from a policy decision of the Committee as to the degree of pressure or ease desired, and on the basis of our knowledge of the present and prospective influences on bank reserves as a result of the operation of natural factors, together with the information that is fed to us on a current basis by the money and securities markets themselves, a decision whether to supply reserves to the market or absorb reserves through open market operations is arrived at. This is a decision that has to be reached each day in the light of all of the factors that I have mentioned before. Our esti-

mates and forecasts of bank reserve positions are subject to wide fluctuations as a result of any number of factors that can only be imperfectly predicted, and I might add that a decision not to undertake open market operations is as difficult as a decision to buy or sell. I should emphasize here that, while the management of the System open market account is in constant touch with the market, the account does not necessarily operate in the market every minute, every hour, or even every day or week.

I think it is obvious that a considerable amount of judgment is required as to the nature, the timing, and the exact amount of any given open market operation. The very nature of open market operations means that they must be approximate and directional in nature, rather than precise, and it is only by a constant review of the impact of our operations on the money market and on bank reserve positions that we can answer the question of how much we should do and when we should do it.

Although the Federal Open Market Committee meets periodically, open market operations must be conducted on a day-to-day basis. While the Open Market Committee lays down a number of guidelines for the manager of the account, such as I have indicated, the nature and complexity of our financial structure precludes the Committee from setting forth a precise schedule of purchases and sales of Government securities that the manager should follow on each day. This should not be taken to indicate, however, that the manager operates solely on his own initiative between meetings of the Committee, and hence has an opportunity to determine policy on his own account. I shall not attempt to go into the many advantages that stem from the regional character of the Federal Reserve System. The fact that we do have a regional system, however, and the fact that the Board of Governors is located in Washington while operations are, of necessity, conducted in New York, does require a highly developed system of communications within the System to insure that each member of the Board of Governors and each president of a Federal Reserve bank is kept fully informed of the manager's operation of the System account on a day-to-day basis.

To start with, each morning there is a conference call at 11 o'clock, at which time the account management talks by telephone with a representative of the Board of Governors and one of the presidents of a Reserve bank who is currenly serving on the Committee. Quite often, Mr. Hayes, the vice chairman of the Committee and his alternate on the Committee, Mr. Treiber, the first vice president of the New York bank, sit in with my associates and myself on this call, and one or more of the Governors of the Board may sit in at the Washington end. After a summary of conditions in the money and capital markets as they have developed during the first hour of trading in the morning, a summary of the reports received from dealers as to the volume of trading in Government securities and their positions at the close of business on the preceding day, a review of the countrywide Reserve positions, with special attention of the Reserve position of the New York and Chicago money market banks, a review of developments expected for the day in the Treasury balance and other information that may appear pertinent, the account management outlines the approach it proposes to take with respect to operations during that day.

(This review of our intentions is, of course, based on our assessment of conditions as they exist at 11 o'clock or thereabouts, and is subject to change should there be a significant change in the market atmosphere.) The other participants in the call may choose to comment on the course of action outlined by the manager and may review any other developments that appear to them to be pertinent in this respect. A rather detailed summary of this discussion is prepared at the Board of Governors and placed before each member of the Board within a short time after the completion of the call. The same information is transmitted by telegram to the presidents of all the other Reserve banks, so that within a very short time the entire System has been alerted to the morning's developments and to the course of action that the manager deems appropriate to implement the policy laid down by the Committee. This rapid dissemination of this information permits each member of the Committee to assess the desirability of the action contemplated by the manager, and to make comments and suggestions if he believes it desirable to do so.

I might add that, while the final responsibility for determining day-to-day operations rests with me, I rely heavily upon the staff work of specialists, traders, statisticians, economists, and others who devote so much of their time to the conduct of our System operations. I am, of course, able to discuss at any time problems that may arise with the vice chairman of the Committee or his alternate on the Committee, and if there are particularly troublesome problems, I may consult directly with Chairman Martin or request a telephone conference of the full Open Market Committee.

In addition to this daily call, which I have described, a written report is submitted daily to the Board of Governors and to interested officers of other Reserve banks, and at the end of each statement week, a full written report of account operations as well as developments in bank reserve positions, the money, Government securities and capital markets is submitted by me to the members of the Open Market Committee and to the other presidents. Similar reports are prepared to cover developments between meetings of the Open Market Committee, including a report which covers developments and account operations up to the close of business on the Monday night preceding a meeting. Thus, when the Committee convenes on a Tuesday morning, it has a full written record of all the activity conducted for the account, as well as a description of the background against which these operations were conducted.

And this is not all. During the course of the day, we submit hourly reports to the Board of Governors on prices and interest rates on Government securities, and indicate on an hourly basis, the operations that have been undertaken by the account mannagement. In addition, a summary of the day's developments is also transmitted by telephone to a member of the staff of the Board of Governors by the trading desk after the close of the market at 3:30 p.m., and a summary of this information is prepared for distribution to members of the Board.

In addition to these informational activities, the system has devised, as part of its emergency planning procedures, a program whereby certain officers and staff members of the other Reserve banks and of the Board of Governors spend 2 to 3 weeks with us at the trading desk in New York. While this program was devised mainly to provide

some measure of continuity in System operations in case of a national emergency, it has served to provide key people in the System with a broad understanding of the scope of, and problems involved in, day-to-day open market operations.

All in all, while this program of information and training takes great time and effort, we feel that it is absolutely essential and that it has been quite effective in keeping the entire System up to date on operations undertaken on behalf of the Open Market Committee. The completeness of the information provided, and its current nature, permits each member of the Committee to be fully informed of the operations undertaken, and provides each member of the Committee an opportunity for continuous review of, and comment concerning, the manner in which the manager is carrying out the instructions he receives at the meeting of the full Committee.

That concludes my statement, Mr. Chairman.

Chairman PATMAN. Thank you, sir. It is a very interesting statement. I appreciate it, and I know the members of the committee appreciate it.

The statement indicates that you have 18 dealers now instead of 17. Who is the 18th dealer?

Mr. ROUSE. I believe that would be Mahlon Andrus & Co.

Chairman PATMAN. They have an office in New York?

Mr. ROUSE. They do.

Chairman PATMAN. Is there any reason, Mr. Rouse, why you should not have a dealer in each of the Federal Reserve districts? In other words, is there any reason why they should all be located in the vicinity of the Federal Reserve bank in New York?

Why couldn't they have one in San Francisco, one in Houston, Tex., one in Chicago, and one in Cleveland, and so forth?

Mr. ROUSE. We do have dealers in Chicago.

Chairman PATMAN. That is the only place that there are dealers outside of New York, and even those have New York offices, do they not?

Mr. ROUSE. In one case they have a New York office. The other has a New York office, but not for Government securities.

One of the other large dealers has its main office or head office in Chicago although its principal office is in New York, if you understand the distinction, and the reason for the principal office being in New York is that is where the markets really are made; the confluence of all the factors having to do with making the market seem to be there.

As far as having dealers located in the other cities, it is a case of having the capital, the know-how, and the volume of business locally to do it.

Chairman PATMAN. That is the deterrent——

Mr. ROUSE. That has not developed as yet.

The prospect in this kind of an economy for the kind of earnings that would be necessary to meet the capital requirements of such a business does not appear to be there, and so we have not had that development.

There is no reason why they should not be if they can see the business prospects to warrant risking the capital.

Chairman PATMAN. Have you given consideration to having the Federal Reserve banks, the other 11 banks, operate as dealers instead of the private dealers that you must really support, in a way, to keep them in a position to make the market?

Mr. ROUSE. No, we would not—we think this would be getting, or I think, I might say, that this would be getting into a realm that would not be appropriate for the Federal Reserve System.

Chairman PATMAN. You operate somewhat as a dealer, at least in one side of the market, at the Federal Reserve bank in New York. Why would it not be all right for the other 11 Federal Reserve Banks to have similarly important parts?

Mr. ROUSE. We do not operate as a dealer, Mr. Chairman. We are a customer of the dealers.

Senator BUSH. Speak a little louder, please.

Mr. ROUSE. I say, Senator, we are a customer of the dealers; we are not dealers.

Chairman PATMAN. You could change the setup, could you not? You would not have to necessarily keep the setup, you could change it.

Mr. ROUSE. We could change it. I might have some question as to the wisdom of having a quasi-Government institution as the dealer, as it would turn out to be——

Chairman PATMAN. Yes.

Mr. ROUSE (continuing). Making the market for Federal securities. This would involve the use of the Federal Reserve's ability to create money in a way that was never intended.

Chairman PATMAN. That is what I mean, making the market. In other words, these dealers make the market.

Mr. ROUSE. They make the market.

Chairman PATMAN. Then they have a position of advantage and privilege in this, with practically all Government bonds going out through them and coming back—they do come back through them; do they not?

Mr. ROUSE. I do not quite understand what you mean by a position of privilege.

Chairman PATMAN. In the sale of Government bonds, they go through the dealers to the person purchasing the bond.

Mr. ROUSE. Quite true.

Chairman PATMAN. Then the same way going back, when the bond is sold it goes back through the dealer. It is a rather expensive operation, and I am just wondering: Why should the Government spend the enormous amount of money, at Government cost—because that is where it finally ends up, I am sure—when you have ways through the Federal Reserve System itself in which this situation could be looked after? I just hope you will give consideration to that, anyway. I know it is a big subject, and I hope you give consideration to it.

I wanted to ask you about these meetings of the Open Market Committee.

Of course, you attend them because you have charge of the account. Now, who else attends these meetings besides the seven members of the Board of Governors and the five FRB presidents who are officially members of the Open Market Committee? The other presidents of the Federal Reserve banks—the seven other presidents of Federal Reserve banks; who else attends these meetings?

Mr. ROUSE. The staff members, as listed in the report.

Chairman PATMAN. How many would you say would be present at a meeting of this type? Twenty-five?

Mr. ROUSE. I would think nearer 35, Mr. Chairman.

Chairman PATMAN. Thirty-five; and it is about the same number every time, and you meet every 3 weeks; is that right?

Mr. ROUSE. That is correct.

Chairman PATMAN. Yes.

Now, as to this information which you have explained in some detail as furnished to the members of the Board of Governors and to the other members of the Open Market Committee, do you furnish that information also to those seven presidents who are not on the Open Market Committee?

Mr. ROUSE. Yes. The wire that I spoke of goes to those seven.

Chairman PATMAN. All of them. In other words, is there any information that you furnish or any contact that you make with the 12 members of the Open Market Committee that you do not also make with the 7 FRB presidents who attend these meetings but are not official members of the Committee? Do you make the same reports to all of them?

Mr. ROUSE. In general; yes. There might be a special meeting of the Open Market Committee.

Chairman PATMAN. In general; yes.

Now at these meetings, when you have a vote to be taken, how do they vote? Do these five presidents vote as such, or do they divide their vote, the 12 of them agreeing on how they shall vote?

Mr. ROUSE. Each member of the Committee decides his own vote, Mr. Chairman.

Chairman PATMAN. But the other seven, although they are not official members at all, they have the right to participate and enjoy the privilege of discussion and present their views, and so forth?

Mr. ROUSE. Yes.

Chairman PATMAN. They do everything except actual voting?

Mr. ROUSE. The members of the Committee have the benefit of their views; yes.

Chairman PATMAN. Beg pardon?

Mr. ROUSE. The members of the Committee have the benefit of their views in arriving at their own vote.

Chairman PATMAN. Yes, sir.

I want to congratulate the Federal Reserve Board on getting the report out earlier this year than they have at times in the past. I have been complaining over a long period about the lateness of this report. I have discovered, on investigation, that while the report has been filed rather early with the Speaker of the House, no publicity has been given to it for months thereafter. In other words, it was filed with the Speaker of the House, and no copies are made generally available. Months later, the Federal Reserve Board makes copies available. This year, thanks to the Federal Reserve Board, they were made available earlier.

Now, I notice at page 41 of their report it says:

"March 1, 1960.

"Authority to effect transactions in System Account." I want you to notice this carefully. You are at the time changing one directive and issuing another; that is, the Board is.

Clause (b) of the first paragraph of the Committee's policy directive was revised at this meeting so as to provide that Open Market operations should be conducted with a view "to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion." This replaced the clause of the directive that had been in effect since May 26, 1959, calling for operations with a view "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities."

What I would like to ask you is, How do you explain the differences in those two directives? As one who is not familiar with this, and certainly one who does not have the knowledge and information that you gentlemen have, I wonder how you arrive at a difference in these two directives. They look to me as being pretty much the same. Yet you apparently think there is a great difference. What is the difference, Mr. Rouse?

Mr. ROUSE. Mr. Chairman, the discussion that preceded the change in this, that is, the discussion——

Chairman PATMAN. You had the benefit of this discussion?

Mr. ROUSE. I had the benefit of this discussion.

Chairman PATMAN. Well, do you also make notes?

Mr. ROUSE. Yes; I usually take one of my associates; often Mr. Stone will come with me, and take some notes.

Chairman PATMAN. Well, does the Open Market Committee have minutes——

Mr. ROUSE. Oh, yes.

Chairman PATMAN (continuing). And record the statements that are made by the different members commenting upon this, and you have the benefit of this?

Mr. ROUSE. We have detailed minutes which, for a meeting, might run 50 or 60 pages.

Each person's views are recorded in those minutes, so they are clear, and because the minutes are somewhat delayed, I do not have them; as I say, one of my associates present takes some notes, so that we can operate before the minutes actually are received.

Chairman PATMAN. My time has expired. I do not want to impose on the other members, but I would like to ask you this short question: Do you also have an interpreting committee in the New York bank to help you in arriving at what is meant?

Mr. ROUSE. Of course, the vice chairman of the Committee is there, Mr. Hayes, the president of the bank, and if I need to consult him I can. But I think I am able to do the interpreting myself adequately.

Chairman PATMAN. Senator Bush.

Senator BUSH. Thank you, Mr. Chairman. Mr. Rouse, I congratulate you upon a very excellent statement, making very clear what your duties are as the head of the Open Market Committee, as manager of the account. It certainly has improved my understanding of the operations and I am very grateful to you.

Now, I want to deal with this question of your operations a little bit, and ask you a few questions in that connection.

I refer to the so-called nudging operation in the long-term market. My recollection is that this was intended to ease the long-term market somewhat, to have the effect possibly of helping interest rates to go down a little bit in the long-term money market, is that correct?

Mr. ROUSE. Senator Bush, I did not come prepared to discuss matters in the area of current policy which, I think, might perhaps be left for Chairman Martin or Vice Chairman Hayes, who are coming here tomorrow. About the only comment I could make——

Senator BUSH. I do not want to get into the question of policies so much; I was leading up to the question of results.

Mr. ROUSE. Well, it is awfully hard to discuss one without discussing the other. But I would say——

Senator BUSH. I am not raising the question with you as to whether this was a wise decision or not.

Mr. ROUSE. I understand.

Senator BUSH. What I want to find out really is what has happened; what effect has this had on interest rates; this is what I want to find out. You should know that as the manager of this account, should you not?

Mr. ROUSE. It has had some effect on interest rates.

Senator BUSH. Sir?

Mr. ROUSE. It has had some effect on interest rates.

I would like to—I really would like to refer you to Chairman Martin's speech which he made down in Florida before the meeting of the Association of Reserve City Bankers, where he outlined this policy somewhat. I would be glad, if you will permit me the time, to read you pertinent parts of this speech.

Senator BUSH. Well, I only have 10 minutes allotted to me, but if the committee would like to hear it, I would be glad to have it come out of the committee's time.

Chairman PATMAN. Perhaps you can insert it in the record in connection with your remarks.

Mr. ROUSE. Perhaps I could read it as part of my remarks.

Chairman PATMAN. Of course, it will be taken out of Senator's time.

Mr. ROUSE. I do not think that would be proper.

Chairman PATMAN. We have an understanding here that we each take 10 minutes the first go around, and then we have more time.

Senator BUSH. Let me go ahead.

Senator SPARKMAN. Will the Senator yield?

Senator BUSH. I yield on the committee's time.

Senator SPARKMAN. Isn't it also our policy if the Senator asks a question and his 10 minutes expires, the witness may continue to answer until he gets fully answered? I suggest to Senator Bush that he hold that over and let it be his last question. [Laughter.]

Senator BUSH. I will be glad to do that if the clerk will tell me when my time is about up.

Let me go back, Mr. Rouse. I would be glad if you would insert in the record those portions of Mr. Martin's remarks that you think appropriate to this question. I want to get back to the question of how much have you done in the long-term bond markets since you have had the nudge to go ahead?

Mr. ROUSE. This terminology, Senator, bothers me. You talk about nudge. We have not talked about nudging.

Senator BUSH. The whole think bothers me. [Laughter.]

Mr. ROUSE. I would much prefer that, if you would not mind, please, for you to take this up with our policy people tomorrow.

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We have probably purchased in other than short-term securities, I would think, about a billion and a quarter.

Senator BUSH. Of long-term, 5 years or more?

Mr. ROUSE. Of securities beyond a year and a quarter.

Senator BUSH. Well, how much of that is beyond 5 years?

Mr. ROUSE. A half billion dollars, I would say, perhaps.

Senator BUSH. How much in round figures?

Mr. ROUSE. About a half billion.

Senator BUSH. Two-thirds then has been in the long-term, the longer term market?

Mr. ROUSE. About one-third.

Senator BUSH. Have you sold during that period any long-term securities?

Mr. ROUSE. No; I think not. This would be a period when you normally don't sell.

Senator BUSH. How far out in maturities have you gone? Have you gone beyond 10 years?

Mr. ROUSE. Yes; we have gone beyond 10 years.

Senator BUSH. Have you gone beyond 20 years?

Mr. ROUSE. I think not. I think we have taken nothing beyond 20 years.

Senator BUSH. What do you expect will happen to these long-term bonds that are, let us say, beyond 10 years that you are buying in this operation?

Mr. ROUSE. I think they will be paid at maturity.

Senator BUSH. I was not worried about that. I was worried about what you were going to do with them.

Mr. ROUSE. I am not worried about them. We have quite a good Government securities market, as a matter of fact.

Senator BUSH. Yes; I know about that, too. But do you intend to hold them to maturity, or do you intend to sell them at a good opportunity?

Mr. ROUSE. Well, may I go back about 20-odd years? At the onset of the war in 1939, there was quite a to do in the Government securities market as the war started, and the market really needed some steadying. It was not a pegged situation, but we acquired, as I recall, some $650 million of bonds, mostly long or a great many long, and, as I recall, also, that was about the first of September of 1939. I think by the first of November we had sold almost all of them. It can be done.

Senator BUSH. Good.

Mr. ROUSE. And the market is a good market.

Senator BUSH. What effect do you observe that your operations in the long-term Government market have had upon the mortgage interest rate for the home builders, and so forth?

Mr. ROUSE. It may have permitted some mortgages to be made that otherwise would not have been made. This I have no direct knowledge of, Senator Bush.

Senator BUSH. I have before me the Economic Indicators. Over there on page 29 a chart shows the interest rate on corporate bonds as of, let us say, last summer and as of the present time, or the end of May, to be just about the same. That is the top line; and the taxable Government bonds which is the dotted line going back to last summer, midsummer, and at the present time there seems to be very little difference there.

Mr. ROUSE. There is quite a marked change in the spread which you will see between the AAA corporate—that smooth line at the top, and the Government securities, taxable Government securities, so that the spread between the two has widened out.

Senator BUSH. The Federal Government security rate went down somewhat.

Mr. ROUSE. It went down somewhat.

Senator BUSH. Slightly.

Mr. ROUSE. May I say that this occurred during a period when the Treasury made an advance refunding, selling a substantial amount of longer term securities. It occurred when the State and municipal market and the corporate market was having, as it is now, a very large demand in the way of demand by industry for new money, and by public bodies for funds for a variety of purposes, roads, schools, water, whatever you want to say.

So that this is rather unusual that the spread between these two would develop this way, and it is over time, as you will see, going back to those two lines, granting a free market, those lines will stay relatively close; and if you attempt, if one should attempt to force, it is a losing game.

Senator BUSH. Well, that is just what I was noticing.

Mr. ROUSE. Does that make your point?

Senator BUSH. In other words, it does not seem to me that the effect of the operations in the longer term market have had any substantial effect on the corporate AAA bonds, and I would also add long-term mortagage market, although that is not shown here.

Mr. ROUSE. Senator Bush and Chairman Patman, because of the point that Senator Bush is making, I feel that there is a real misunderstanding of this whole situation, which I want to clarify by reading this statement of Chairman Martin's.

Senator BUSH. I would like to ask unanimous consent of the committee that the gentleman be allowed to read that statement, and I will yield back the balance of my time for that purpose.

Chairman PATMAN. Without objection, so ordered.

Go ahead.

Mr. ROUSE. Thank you, thank you both.

"Since the Federal Reserve instituted its all-maturities"——

Senator BUSH. Read it out so we can hear it.

Representative REUSS. When and where was this statement made?

Mr. ROUSE. This statement was made before the annual meeting of the Association of Reserve City Bankers at Boca Raton, Fla., April 11, 1961. [Reading:]

Thus, the Federal Reserve began, last October, to provide some of the additional reserves needed by buying certificates, notes, and bonds maturing within 15 months, somewhat longer than the 12-month limit we had usually held to prior to that time.

Then, on February 20 of this year, Federal Reserve began to buy securities having maturities beyond the short-term area.

The twofold purpose of this new practice of operating in all maturity sectors of the Government securities market is to see whether we can provide reserves necessary to stimulate business without fostering further outflow of liquid funds.

Some people have said, "You are trying to make water run downhill in one direction and uphill in another. It can't be done." Quite frankly, nobody can be sure as yet how much can be accomplished by these operations. But the

problem is there, and we must make every effort to solve it. That we intend to do.

Since the Federal Reserve instituted its all-maturities procedure 7 weeks ago, there has been, quite naturally, considerable discussion about the procedure itself and still more about its results to date.

In much of this discussion, it seems to me, there has been a mistaken overemphasis placed upon the levels of interest rates, as if some particular level of rates could be in themselves an objective of monetary policy.

That is not the case. What the Federal Reserve is seeking to do is not to set some particular level of rates for either short or long-term securities, but rather to influence the flow of funds in international and domestic channels.

The progress of its efforts, therefore, cannot be measured merely by matching the level of rates prevailing at any given time with the rates prevailing just before transactions were extended to all maturities.

To me, it would appear, the best gages of that progress are these: In respect to short-term rates, whether the outflow of funds to foreign centers is being stemmed; and in respect to long-term rates, whether the flow of capital into productive investment activities is being facilitated.

And going on somewhat further in the speech, he says:

Furthermore, I would hope that it would be clear to everyone by now that we have never intended to try to establish an arbitrary rate level. Instead, we have recognized from the beginning that the effectiveness of Federal Reserve operations depends heavily upon the reactions of investors. Also, that investors are very likely to react adversely to attempts to set rates arbitrarily, and hence are likely to make any such attempts self-defeating by moving their investments elsewhere. In our country, the Government cannot compel anyone to invest or lend his money at rates he is unwilling to accept, any more than it can compel anyone to borrow at rates he will be unwilling to pay. That is a fact that no public authority can ever afford to ignore.

What we have been trying to do is to operate over a wider range in the execution of our transactions, and thus to register more speedily in the various maturity sectors of the market whatever direct impact our transactions can make. But our operations have been within the framework of a free market. We have respected the freedom of investors to decide what they wish to do, and the necessity that the market remain basically free to reflect the underlying forces of general supply and demand that mainly shape both the trend of interest rates and the flow of funds.

I might add that I think that we have been reasonably successful in these respects. There has been a stemming of the outward flow of short-term funds abroad; there has also been a very large volume of new securities issued in terms of both private securities and public securities, and they have been taken, the funds have been available to purchase these, and a real flow of funds has been stimulated and, in part, it may be credited, I think, to the present policy of the Federal Reserve System.

Senator BUSH. Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

Senator Sparkman.

Senator SPARKMAN. Mr. Chairman, I have not had the opportunity to complete the reading Mr. Rouse's statement. I would like to do that.

I will ask a few questions based on the statements just made.

Now, if the purpose of the open-market operation is not to affect the interest rate, what is its purpose?

Mr. ROUSE. It is to primarily affect bank reserve operations. Incidentally, it also certainly has an effect on interest rates, and that has to be taken into consideration as well.

Senator SPARKMAN. In other words, if it does have an effect upon the money supply, upon the operations and the activity of the bond

market, would it not inevitably result that there would also be an effect upon interest rates?

Mr. ROUSE. That is correct. If reserves are withdrawn from the market and the banks have a smaller base on which to base their lending or investing operations, it presumably would result in their restricting along that line, and the ultimate raising of rates, or vice versa.

Senator SPARKMAN. In fact, I remember back in the early part of this year there was some discussion in the papers, and I believe that we had some testimony in the hearings of this committee, with reference to the operations of buying long-term securities for the purpose of helping to lower the interest rate on the long-terms, while maintaining the interest rate on the short-term securities; is that not correct?

Mr. ROUSE. Sir, as I recall—I might say——

Senator SPARKMAN. As a matter of fact, my recollection may be hazy on it, but I was under the impression that Mr. Dillon himself stated that as being the objective.

Mr. ROUSE. Well, Mr. Dillon may have said so. The only——

Senator SPARKMAN. I do not say it positively, but it seems to me that he did say something about that in his testimony before this committee.

Mr. ROUSE. I think, by and large, the Treasury and the System have been working very well together.

On the other hand, I cannot recall any statement by a senior Federal Reserve official along this subject, other than that that I have just read to the committee.

Senator SPARKMAN. Now, just noticing in our report, I notice this statement:

> On February 20, the Federal Reserve announced that the Open Market Committee would begin purchasing long-term Goverment bonds—thus shifting some of its holdings from short-term to long-term securities—so as to reduce long-term rates without also reducing short-term rates.

I am sure that is based upon testimony before our committee.

> Accordingly, during the following week the Open Market Committee began purchasing—

by the way, if you have a copy of that report, our report on the President's economic report, I am reading from page 17.

Mr. ROUSE. Yes.

Senator SPARKMAN (reading):

> Accordingly, the following week the Open Market Committee began purchasing the long- and intermediate-term bonds seemingly carrying out the announced policy. In this week, there was a significant drop in the market yield on long-term Government bonds. For example, yields on bonds over 10-year maturities dropped from 3.81 percent on February 18, to 3.76 percent on February 25.
>
> When the Federal Reserve's subsequent weekly report was published, however, it turned out that it has bought a total of only $13 million in bonds—$7 million in the 1- to 5-year maturity range, $6 million in the 5- to 10-year range, and none of the longer maturity.

I will not read further, but we indicate there that perhaps the discovery by the public that the operations of the Open Market Committee were so limited perhaps kept it from having a significant effect upon the interest rates.

Mr. ROUSE. The operation, as I indicated earlier, Senator Sparkman, is a matter of putting reserves into the market to the extent that there is occasion to put reserves in under the conditions that prevailed that particular week, if you will.

It may be that there, based on the current policy of the committee, may be a reason to put $50 million of reserves in the market in the week.

In the normal course, assuming a policy free to invest in any of the maturity range, the bulk of that normally would be done, I should say, in short-term securities. But to the extent that longer term securities are available in the market, a proportion of those would be taken and that is, of course, what happened there.

It was not a project to go out and seek these securities for other than reserve purposes.

If, by reason of purchasing some of these longer securities for reserve purposes it had an effect on interest rates in the direction that you suggest, that would be a desirable byproduct under the conditions that we have had in the past 6 months.

Senator SPARKMAN. Well, I would certainly agree with that statement. However, I think the only difference in what you say and what I think is that it is a significant thing and something that certainly seems to me would be in mind all the time that the operations were taking place.

Mr. ROUSE. I just think, sir, that there has been a general misapprehension or misunderstanding of what the System is doing, and that is why I wanted the privilege of reading that statement of Chairman Martin's, which I thought stated the situation with clarity.

Senator SPARKMAN. I agree with you. Yet it seems to me that the point is that if you know it is going to have this effect, you simply cannot lose sight of the operations.

Mr. ROUSE. Following this statement that you refer to, of course, it created expectations in the market because we had had a bills-only, or a bills-preferably situation for a long time, up until last fall. And then our operations were extended by reason, primarily, I should say, of the balance-of-payments situation, into the somewhat longer securities, so that there would not be the same degree of pressure on short-term rates. The extension of operations created a degree of expectation in the market, and the fact that these operations in the earlier part of this period were light, probably reduced those expectations in a healthy way.

Senator SPARKMAN. That is all, Mr. Chairman.

Senator BUSH. I was just going to ask if the Senator would yield for one question.

Senator SPARKMAN. Yes.

Senator BUSH. You pointed out the difference in the market between February 18 and February 25, it having dropped in that week from 3.81 to 3.76, and I just notice on the Federal Reserve Board's table in these papers here that on May 27 it was 3.78 as against 3.76 on February 25. So that whatever was done in that period has not had the effect of changing the long-term interest rate materially, that is, the rate on bonds of 10 years and more, long-term rates.

Senator SPARKMAN. Yes.

Senator BUSH. So I suppose they could contend, if they had not been in there the rate would have gone up.

Mr. ROUSE. Senator Sparkman——

Senator SPARKMAN. Yes.

Mr. ROUSE. During this period from February 20 until and through the present period, we, perhaps, hit the trough of the recession about that time. Better business prospects——

Chairman PATMAN. Will you speak a little louder, please?

Mr. ROUSE. The better business that is developing, not only the prospects but actually the better business that is developing, the better degree of employment that seems to be developing, the greater confidence that has been developed in the dollar, all these things made for a healthier situation I should think, and one that would, in the ordinary course, suggest to market people that the course of interest rates would not be down.

I think a good many people in the market think that rates could well stay in the range that they are. There are others who think they could go up. But in the rising tide of business, one does not expect that rates decline, and in view of all these factors, the fact that these rates have stayed in the same range which Senator Bush mentioned, suggests that this has had the effect of developing the flow of funds that was needed to stimulate business, in the sense that we are all talking about it.

Senator BUSH. Thank you, Mr. Chairman.

Chairman PATMAN. Representative Widnall?

Representative WIDNALL. I just have one question, Mr. Chairman. What confuses me, the contention seems to be made if you succeed in lowering interest rates on long-term bonds that it attracts more money into the long-term market. Now, isn't it exactly the opposite which is true?

Mr. ROUSE. Generally speaking, yes.

Representative WIDNALL. Doesn't it tend to drive people into short-term securities or take them out of the Government market?

Mr. ROUSE. If there were an effort to force rates lower, it would have that effect. That is an individual judgment, I might say.

Representative WIDNALL. That is all.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Mr. Rouse, would you give me, please, your definition of short-term Government securities, intermediate-term Government securities, and long-term Government securities? What are the maturity figures?

Mr. ROUSE. As of this time, I would class short-term Government securities as securities maturing within 5 years; intermediate securities——

Representative REUSS. You disturb me a bit, if I may interrupt you. We are talking about the English language, and that does not change from time to time.

Mr. ROUSE. Well, it is a matter of opinion, sir.

Representative REUSS. Come, come; words are words, are they not?

Mr. ROUSE. Well, words are words. Short may be 5 years at times, and it may be long at times. I said as of now, as of now.

Representative REUSS. All right. Give it to me as of today, June 1; What is a short term, what is an intermediate term, and what is a long term?

Mr. ROUSE. I would regard securities maturing within 5 years as short-term securities; between 5 and 10, roughly, are intermediate securities; and beyond that are the long.

Representative REUSS. All right.

When did the English language change its meaning—when did short term, intermediate term, and long term mean something else?

Let us go back from today, June 1——

Mr. ROUSE. Let us go back to the onset of war again.

Representative REUSS. Well, let us just take a look backward from today, June 1, 1961. You told me what they mean today.

Mr. ROUSE. All right.

Representative REUSS. Now, what are these Alice-in-Wonderland type words, what do they mean at various other times? What did they mean on May 1, month to month—what did they mean on May 1, 1961?

Mr. ROUSE. I do not recall, sir.

Representative REUSS. Will you make an effort to recall, and will you consult your colleagues, because this is quite important.

Mr. ROUSE. Let me illustrate it, sir, by saying that, we will say, at the onset of a war, where everybody wants out, they want liquidity, short means tomorrow or today; it does not mean tomorrow or next week or next year or 5 years from now. But there are times when short to investors means up to 5 years.

Representative REUSS. Well, let us just take it back on a month-to-month basis. Will you please tell me, and consult with your colleagues if you need to, to refresh your recollection, what the terms "short term" and "intermediate term" meant on May 1, 1961, a month ago? Did they mean anything different at that time from what you have just testified that they mean today?

Mr. ROUSE. The same thing I should say.

Representative REUSS. The same thing. April 1, 1961?

Mr. ROUSE. The same thing.

Representative REUSS. March 1, 1961?

Mr. ROUSE. I do not see any difference.

Representative REUSS. February 1, 1961?

Mr. ROUSE. I do not think I see any difference.

Representative REUSS. January 1, 1961?

Mr. ROUSE. No.

Representative REUSS. December 1, 1960? Is the plot thickening at this point?

Mr. ROUSE. No, I do not get your point, I am sorry.

Representative REUSS. Well, I just want to know what the words "short term," "intermediate term" and "long term" mean, in Federal Reserve parlance, and you startle me by saying——

Mr. ROUSE. Excuse me.

Representative REUSS. When you say they are Alice-in-Wonderland kind of words, that they mean different things at different times. I, therefore, want to know what they mean at different times, and we are now back to December 1, 1960, and I am asking you the question which I have asked for every month back until then.

On December 1, 1960, do short terms mean 5 years and under, intermediate terms 5 to 10 years, and long terms 10 years and over?

Mr. ROUSE. They do to me. You changed the question, if I may say so, just now in that Federal Reserve parlance, our Federal Reserve terms. Now——

Representative REUSS. Is the meaning in your mind something different from what it is in Federal Reserve terms?

Mr. ROUSE. This may be a misunderstanding, Mr. Reuss, but a good many people in the System consider short-term securities to be those maturing within 15 months; some regard them as Treasury bills only. But, generally speaking, we will say 15 months; that stems from our repurchase agreement machinery which provides that repurchase agreements may be made against securities maturing under repurchase, or resale contracts if you will, maturing up to 15 months. They regard those as short-term securities, and that is the nearest thing to a definition that we have in the System, to my knowledge.

Representative REUSS. But up until now, in telling me the definition of short terms, intermediate terms, and long terms, you were giving me your own definition?

Mr. ROUSE. I was.

Representative REUSS. Well, let us continue our backward walk. What about—have you yet answered me as to whether the definitions on December 1, 1960, were the same as they are today?

Mr. ROUSE. Yes.

Representative REUSS. All right. November 1, 1960.

Mr. ROUSE. So far as I recall; yes. This is getting back where it is foggy.

Representative REUSS. Well, I will make it easier for you. Will you tell me when the definitions of short terms, intermediate terms, and long terms differed from what they are today?

Mr. ROUSE. In almost any period of stress.

Representative REUSS. Well, when was the——

Mr. ROUSE. Take the Korean war, the onset of the Korean war.

Representative REUSS. Is that the first one, going backward, nothing for 10 years?

Mr. ROUSE. Of course not.

Representative REUSS. Then tell me the first time prior to today when short terms, intermediate terms, and long terms, in your parlance, not in the Federal Reserve parlance, meant something different, respectively, from 5 years and under, 5 to 10 years, and 10 years and over?

Mr. ROUSE. I would say that the first thing that occurs to me is the period July 1958.

Representative REUSS. What, in your lexicon, did short terms, intermediate terms, and long terms mean in July 1958?

Mr. ROUSE. Anything beyond Treasury bills was long term.

Representative REUSS. In other words, a short term was 30 days, and there was no such thing as an intermediate term?

Mr. ROUSE. No.

Representative REUSS. So intermediate terms and long terms were melded into one, and covered everything from 30 days up at that time.

Mr. ROUSE. Everybody wanted out.

Representative REUSS. And that prevailed during the month of July 1958?

Mr. ROUSE. It wore off in time. Gradually, and short term began to be longer, and has steadily worked out, we will say, to where we are now.

Representative REUSS. I will now call your attention to a document with which you are thoroughly familiar, that being the statement of Open Market Policy adopted in 1953, and expressly approved and continued by the Open Market Committee, on March 22, 1960, with Messrs. Hayes and Bopp dissenting. This is referred to on pages 47 and 48 of the report. In there the law of the Medes and Persians, for your guidance, was set forth as short-term securities. You were to confine your purchases to short-term securities.

Now, I am told, to my amazement, that this term has no constant meaning in your minds, but that it can mean anything from 30 days to 5 years.

This makes me very uneasy, sir, because we, in Congress, have had to rely on annual reports, and we assumed words had some continuing meaning.

Can you help me out on my difficulty?

Mr. ROUSE. Yes, sir. I would like to repeat what I said with regard to the repurchase agreements, that generally speaking, in the system presently, short-term securities are regarded as those maturing within 15 months.

Representative REUSS. And that is today?

Mr. ROUSE. That is today. If I were asked to recommend a definition for it, the whole atmosphere of the system and its attitude, and you gentlemen, and having the need for precision, if I were asked, I would recommend that the committee, if it were wanting to define it publicly, to define it as 2 years.

Representative REUSS. It is a fact, is it not, that the Open Market Committee on March 22, 1960, expressly reaffirmed the 1953 policy directive which related to short-term securities?

Mr. ROUSE. March 22, 1960, did you say?

Representative REUSS. Yes. That is set forth on page 47 of the report, and I assume that it is an accurate account.

Mr. ROUSE. Yes, sir.

Representative REUSS. It is also a fact, is it not, that no action taken later on in the year 1960 in any way changed the reaffirmation of the policy with respect to short-term securities?

Mr. ROUSE. That is correct; and the understanding of short-term securities through 1960, as far as the Federal Open Market Committee is concerned, and its manager of the account, is 15 months.

Representative REUSS. Is it not a fact that late in 1960, in November or December of 1960, the Open Market Committee purchased securities which had as much as 4 years or more life left in them?

Mr. ROUSE. No; it is not correct.

Representative REUSS. What was the maximum remaining maturity purchased by the Open Market Committee in 1960?

Mr. ROUSE. February 1, 1962.

Representative REUSS. Those were——

Mr. ROUSE. That would be a little under 15 months.

Representative REUSS. So that—I am told my time is running out—so that the Federal Open Market Committee was operating under a different definition of what a short-term security was than was possessed by the—what did you say, the system generally, which I take it, the banking system?

Mr. ROUSE. No. The Open Market Account and the Open Market Committee were operating under a definition of short-term securities at that time of 15 months, and that is still the case.

Representative REUSS. Time has run out. I will return to this.

Chairman PATMAN. Representative Griffiths.

Representative GRIFFITHS. Thank you, Mr. Chairman.

I would like to ask you some questions, if I may, Mr. Rouse, about the mechanics of the operation.

You refer to a periodic meeting of the Open Market Committee. Are stenographic reports kept of those meetings?

Mr. ROUSE. No, they are not, Mrs. Griffiths.

Representative GRIFFITHS. Why not?

Mr. ROUSE. There has been no need for that. The Committee has an adequate secretariat that does a very good job with minutes.

Representative GRIFFITHS. Are policy decisions made at those meetings?

Mr. ROUSE. They are.

Representative GRIFFITHS. Do you think it would be of some value to have, historically to have, an absolutely accurate account of what happened?

Mr. ROUSE. No, I do not see—this is a good job that a good secretary can do.

Representative GRIFFITHS. Do you have secretarial reports of the meetings?

Mr. ROUSE. We have an excellent secretariat that does a first-class job.

Representative GRIFFITHS. At the 11 o'clock morning conference do you have a taped record of those meetings?

Mr. ROUSE. We do not.

Representative GRIFFITHS. Do you have a secretarial report of that?

Mr. ROUSE. We do not.

Representative GRIFFITHS. Why not?

Mr. ROUSE. A report is made, as I have indicated, by means of a memorandum. This is a matter of several people listening on each end of the telephone. At the Washington end a record is kept, a memorandum written immediately thereafter, which is cleared with each of the people who were on the receiving end.

Representative GRIFFITHS. You mean in Washington a record is kept, but you do not keep a record?

Mr. ROUSE. In Washington. No; we have a record of the facts we mentioned, and the substance of what we have said.

Representative GRIFFITHS. But you do not have an accurate record of exactly who said what?

Mr. ROUSE. We have an accurate record, but we don't have a taped record or a detailed record of that sort.

Representative GRIFFITHS. I see.

Does Washington permit each one of you to go over the statement and determine that actually you did say thus and so?

Mr. ROUSE. This wire that we receive from the Board, that is, the President of the New York bank and I receive it, and the Presidents of the other Reserve banks, each receive it, and we have an opportunity, if it is incorrect, to say so; and sometimes there is a mechanical error which we catch and not—I do not recall any error of substance, but there have been transpositions, and the like, and they are caught and referred and checked, so that the substance is checked.

Representative GRIFFITHS. I would think that with today's mechanical gadgets it would be simplest to keep an absolutely accurate record.

If you cannot offhand tell me, will you supply for the record, if that is all right, Mr. Chairman, the precise factors and measures taken into account on the day on which—let us say the last time—a policy of restraint was instituted, together with the factors and measures on the preceding day when you had not yet instituted this policy of restraint. Could you do that?

Mr. ROUSE. I will endeavor to comply with that. It is a little difficult.

Chairman PATMAN. You will supply it for the record, will you, Mr. Rouse?

Mr. ROUSE. Yes.

Chairman PATMAN. Without objection, it is so ordered.

(The information referred to is as follows:)

RESPONSE TO LETTER FROM CHAIRMAN PATMAN

Response to request for "a description of all the factors which the Open Market Committee took into account on the last occasion when it instituted a policy of restraint, and a description of the factors which it took into account on the occasion of the immediately preceding meeting, prior to institution of a policy of restraint" (letter from Chairman Patman dated June 14, 1961)

Ordinarily, changes in monetary policy come about through an evolutionary process. Rarely if ever would policy be reversed abruptly, or changed drastically at one meeting of the Committee from that in effect at the preceding meeting, except in dramatic circumstances such as, for example, an outbreak of war.

The latest occasion when a policy directed toward tempering the rate of monetary expansion was instituted by the Federal Reserve was in the latter part of 1958 and the first half of 1959, when the economy made a sharp, V-shaped recovery from the recession that had begun in the latter part of 1957, and when an inflationary psychology emerged as a threat to sustained progress.

At the beginning of 1958, as shown by the Record of Policy Actions of the Federal Open Market Committee set out in the Board's annual report covering that year, the Committee's directive called for operations with a view to cushioning adjustments and mitigating recessionary tendencies in the economy.

Thereafter, during 1958, the directive was changed or modified several times. Yet, although the Committee noted as early as its meeting on May 27 that a bottom to the decline might be in the making, it was not until August 19, 1958—by which time "vigorous revival in domestic economic activity was taking place" and a special operation to cope with disorder in the Government securities market and its aftermath had been completed—that a change was made in the directive away from a policy of substantial ease appropriate for continuing recession but not for recovery.

Following that action in August, reserves needed to cover expansion in credit and the money supply that accompanied economic recovery were in part supplied by Federal Reserve actions and in part obtained through a moderate increase in member bank borrowings. Not until May 1959, however, did the Committee's directive call for a positive policy of restraint on inflationary credit expansion. The following summary of changes in the Committee's policy directive is taken from page 69 of the annual report for 1958:

"The Open Market Committee's directive in effect at the beginning of 1958 called for operations with a view to cushioning adjustments and mitigating recessionary tendencies in the economy. This was changed at the March 4 meeting to provide that transactions should be with a view to contributing further by monetary ease to resumption of stable growth of the economy. The next change in the directive was made on July 29, but during the period July 18 to July 24 the terms of the instruction adopted March 4 were temporarily superseded when the Committee gave a special authorization for the System Account to purchase Government securities, without limitation as to amount or maturity, for the purpose of correcting a disorderly condition in the Government securities market. That special authority having been terminated on July 24, the directive was modified at the meeting on July 29 to specify that operations should be with a view to recapturing redundant reserves that were expected to be released to the market August 1. A further instruction adopted on August 4, by which time the redundant reserves had been recaptured, called for keeping from having redundant reserves return. At the August 19 meeting, the directive was changed to provide for operations fostering conditions in the money market conducive to balanced economic recovery. This wording remained unchanged until the meeting on December 16, when it was modified to an instruction that operations be with a view to fostering conditions in the money market conducive to sustainable economic growth and stability."

The evolution of policy, which will be developed in some detail later from the Record of Policy Actions in the Board's annual reports for 1958 and 1959, indicates the care taken by the Committee, before the institution of a marked change in policy, to be sure that the change is warranted.

They also demonstrate that the determination of monetary policy is a continuous process requiring continuing adaptation to economic and financial developments. Thus, changes in monetary policy, like changes in the economy itself, usually are gradual rather than sudden and sharp. Or, as Chairman Martin described the process in a talk several years ago:

"Monetary policy * * * must be tailored to fit the shape of a future visible only in dim outline. Occasions are rare when the meaning of developing events is so clear that those who bear the responsibility can say, 'As of today, our policy should be changed from ease to restraint'—or from restraint to ease, as the case may be. What is true of a change in policy is also true of a shift in policy emphasis: it is rarely decided upon in a single day. More typically, as is evidenced by open market operations, the outline of a shift in policy emphasis, like the outline of the future, emerges gradually from a succession of market developments and administrative decisions. It is a poor subject for the photoflash camera to capture as a clearly defined still life, or for a news story to etch in spectacular outline. Getting a perfect garment for the future may require several fittings."

Hence, factors considered and analyses undertaken by the Committee during a meeting chosen as marking the beginning of a policy of restraint (or of ease) might not seem strikingly different from those at the meeting immediately preceding it or at other meetings somewhat farther back in time.

In decisions of the Committee, as in decisions by others, the cumulative effects on judgments that come from long study and consideration may be extremely difficult to weigh precisely, but few would dispute that they do have a weight just the same.

Examination of the policy record entries in the 1958 and 1959 annual reports, in chronological order, shows the first 1958 change in the directive was made at the March 4 meeting. The change, and the explanation therefor, are shown by a paragraph beginning at the bottom of page 41 of the report that reads as follows:

"The Committee's discussion of the situation disclosed considerable feeling that the policy directive should reflect a more positive approach to recovery than was embodied in the wording [of the directive then in effect] calling for 'cushioning adjustments and mitigating recessionary tendencies in the economy.' Agreement was reached on the change indicated, namely, that during the period following this meeting open market operations should be with a view to 'contributing further by monetary ease to resumption of stable growth of the economy'."

The Committee's next meeting, on March 25, at which information was received of a further decline in output and employment and a sharp rise in unemployment, produced the following indicative entry, shown on page 44 of the annual report:

"While making no change in the existing policy directive, the Committee concluded that operations in the System [Open Market] Account should be directed toward maintaining a slightly larger volume of free reserves and money market conditions slightly easier than had been achieved since the last meeting of the Committee."

The policy stance thus adopted was maintained without change, as was the directive, through the next five meetings despite indications of economic improvement such as are reflected in these excerpts from the 1958 policy record entries:

At the meeting of April 15 (see p. 44 of the 45th annual report):

"Data available to the Committee indicated some slowing down in the pace of decline for total output and employment, some leveling out in trade, and maintenance of construction activity at close to record levels in value terms. In contrast, there were some developments of an expansive character in finance. While the picture domestically therefore appeared as one of more diversity or crosscurrents than earlier in the year, the overall drift of the economy nevertheless was still plainly downward."

Meeting of May 6 (see p. 47):

"Although some statistical evidence suggestive of a slowing of economic decline had been accumulating, most of the information available to the Committee at the time of this meeting indicated that the recession was still deepening and that a bottom was yet to be established."

Meeting of May 27 (see pp. 48–49):

"The composite of current economic indicators reported at this meeting suggested that the recession in economic activity had been levelling off and that a bottom to the decline might be in the making. The decline in industrial production, over all, seemed to have been checked in May, and a number of other indicators, including retail sales, personal income, residential building, and new orders received by durable goods manufacturers, likewise appeared to have stopped receding or to have risen slightly."

Meeting of June 17 (see p. 51):

"Economic information available for this meeting was generally on the encouraging side and was confirmatory of the report at the May 27 meeting that bottoming out of recession was in fact occurring. However, analysis of the data suggested that the haze obscuring the outlook had not suddenly lifted, and that it was the better part of wisdom not to conclude as yet that a recovery pattern had definitely taken form. On the other hand, it could not be denied that there was a possibility that an accelerating recovery movement was now shaping up."

Meeting of July 8 (see p. 52):

"A summary of the economic data presented at this meeting was that performance of the economy in May and June had been better than had been anticipated. The index of industrial production over those 2 months had risen two points, and final data might show the rise to be three points. Gross national product for the second quarter was currently estimated to be at least moderately higher than in the first quarter. Whether an abrupt turnabout of activity was taking place or whether the extended improvement merely reflected a temporary rebound of production that had been far below consumption was yet to be determined. However, the odds seemed to favor more than a rebound improvement."

Shortly after the meeting on July 8, 1958, events in the market for Government securities forced the Committee to turn its primary attention from developments in the economy and to concentrate its efforts on dealing with disorderly conditions arising in the Government securities market.

To that end, several Committee meetings were held during the second half of July by special telephone conference arrangement. On July 18, the Committee authorized the purchase of Government securities in the open market without limitation as to amount or maturity; and on July 24, the Committee terminated the special authorization because conditions in the Government securities market had steadied sufficiently to make it no longer necessary.

Although the operations authorized at the special telephone conference meeting on July 18 had been oriented to market rather than economic conditions, and in that sense had constituted a policy digression rather than a change, they produced, inevitably, a new problem of economic import in the form of a superabundance of bank reserves.

With that problem the Committee dealt when next it gathered in Washington on July 29, with the result that the wording of the directive was changed for the first time since March 4, to restore the status quo ante in the level of reserves. The nature of the change and the reasons therefore are explained by the policy record entry for that meeting on pages 57, 58 of the 1958 annual report:

"At this meeting reports of economic developments made it reasonably clear that April had marked the recession trough and May the first month of revival in economic activity. Evidences accumulating for June and July confirmed the broad image of increased industrial output that had been reported at the July 8 meeting of the Committee. In addition to the statistical data, indications of improvement in business sentiment suggested that an uptrend in economic activity might now be underway. The growing evidences of business improvement, together with the possibility that the degree of monetary ease prevailing in recent months might produce a very rapid expansion in bank credit and the money supply, raised the question whether the Committee should consider some modification of the degree of ease that had developed in recent months.

"During the 2 weeks preceding this meeting, System operations had been largely concerned with correcting disorderly developments in the Government securities market, rather than with current economic and credit needs. This was in accordance with the authorization given by the Committee at a special meeting on July 18 to purchase Government securities without limitation for the purpose of correcting a disorderly market.

"In the 5-day period from July 18 to July 23, the System account had purchased $1.2 billion of securities, largely when-issued securities involved in the Treasury financing, but also a small volume of other notes and bonds. These purchases had been made under the specific authorization given on July 18 and within the general framework of the Committee's continuing operating policies that had been in effect since 1953, and which were last reaffirmed on March 4, 1958. Payment for the securities involved in the Treasury financing would result in a substantial rise in the volume of member bank reserves on August 1, over and above the level that had been maintained during the past 7 or 8 months, and the Committee gave consideration to what would be the effect of such a substantial increase in the availability of reserves. In light of the evidence of improvement in the economic situation, which suggested that the directive that had been in effect since March 4 was no longer appropriate, and in view of the decision of July 24 that the need for action to correct a disorderly condition in the Government securities market had passed, the conclusion was reached that for the next 3 weeks the problem for the Committee would be one of absorbing the redundant reserves that would be entering the market, insofar as that could be done consistently with an orderly market in Government securities. Thus, the Committee modified its directive in the manner indicated to require that operations be conducted with a view to recapturing redundant reserves that were expected to be released to the market on August 1."

Pending its next regular meeting, which was scheduled for August 19, 1958, the Committee had another special telephone conference session on August 4 at which it agreed to follow an interim policy of "keeping from having redundant reserves."

At the August 19 meeting, having disposed of the problem of market disorder and its aftermath, the Committee, focusing primary attention once more on problems of the economy, took especial note of "vigorous revival in domestic economic activity" and, at the same time, expressed concern over "the emergence of an inflationary psychology in the stock market and other financial markets that could easily spill over into commodity and real estate markets." It was at this meeting that the wording of the policy directive was changed from a posture of pronounced ease to a policy of "fostering conditions in the money market conducive to a balanced economic recovery." To carry out this changed directive, the Committee decided that open market operations "should move in the direction of lower free reserves."

This was the explanation of the Committee's action in the policy record entry for the August 19 meeting, as shown on pages 59, 60 of the annual report:

"Information presented at this meeting showed that vigorous revival in domestic economic activity was taking place. Similarly, in Canada revival appeared to be underway. In Europe, production trends had been mixed, with contractions, where occurring, apparently associated with inventory adjustment.

"In the United States the Board's index of industrial production through July had risen at least seven points or 6 percent, from April, and it seemed pos-

sible that late data might raise the amount of advance. Regional reports bore out the national trend, although some important areas of the country were still not experiencing much recovery and the total number of unemployed persons nationally remained disturbingly large.

"Domestic financial developments since late July included further expansion in bank credit, which had risen by $7 billion in the first 7 months of the year. Financial markets had been influenced by the stream of economic data and corporation reports indicating that vigorous recovery was underway; by indications and rumors that Federal Reserve policy might be shifting away from ease (the Board of Governors of the Federal Reserve System had increased margin requirements for purchasing and carrying listed securities from 50 to 70 percent, effective August 5, 1958) ; and by a flow of banking, monetary, and Treasury deficit data pointing to a sharp increase in the cash balance position of the economy.

"In considering policy, the Committee was faced with the fact that the large Federal Government deficit would have to be financed during a period characterized by broadly spread revival of productive activity and incomes and an abnormal expansion in privately held cash balances, and by the emergence of an inflationary psychology in the stock market and other financial markets that could easily spill over into commodity and real estate markets. Notwithstanding the substantial numbers of unemployed persons, the data presented indicated that the rate of expansion in the money supply in the immediate future should be tempered and that operations for the System open market account should move in the direction of lower free reserves without seriously disrupting the Government securities market. The fact that seasonal influences would be working in this direction through the Labor Day weekend suggested that, without too much pressure, the System account might be able to move in the direction of the elimination of free reserves by the time of the next meeting * * *."

"In its discussions of the policy directive the Committee also considered the market structure of interest rates, noting that the discount rate of the Federal Reserve Bank of San Francisco had been increased from 1¾ to 2 percent effective August 15, 1958. The reasons for this rate increase * * * were reviewed at this meeting, and the rate increase was considered to be consistent with the action taken by the Open Market Committee in deciding to move toward reduced reserve availability."

Operations under this new directive with a view "to fostering conditions in the money market conducive to balanced economic recovery" were considered appropriate by the Committee throughout the fall of 1958 as recovery in output, income, and consumption continued. During these months, member banks continued to have free reserves, with a moderate level of borrowings at the Reserve banks; Federal Reserve bank discount rates were raised from 1¾ to 2½ percent in two steps; and credit and monetary expansion continued, although the rate of rise was reduced.

As indicated in the policy entry for the meeting of December 2, on page 67 of the annual report:

"Overall, it was apparent that the domestic recovery that had shown up during the summer months had now gone far enough to be on the verge of a new expansion period, with the possibility that the rise in activity would carry major indexes of activity into new high ground."

Although the Committee's directive, as renewed at that meeting, continued to provide for open market operations "fostering conditions in the money market conducive to balanced economic recovery," its conclusion contemplated letting market developments tend to increase restraint within limits consistent with the policy directive and the broadening economic recovery.

At the following meeting, on December 16, by which time there had been a moderate tightening of bank reserve positions, economic activity had approached sufficiently to previous peak levels to direct attention to the problems to be considered in a period of renewed economic expansion. It was at this meeting that the Committee's policy directive was changed to provide that transactions be conducted with a view "to fostering conditions in the money market conducive to sustainable economic growth and stability."

By the end of 1958, then, the problem, in the view of the Open Market Committee, was no longer one of promoting economic recovery, but of creating monetary and credit conditions favorable to a period of renewed economic expansion. Accordingly, during the first part of 1959 the Committee moved gradually toward a policy of restraint, as is apparent from the following quotation from page 64 of the annual report for that year:

"The policy directive of the Open Market Committee in effect at the beginning of 1959 was aimed at fostering conditions in the money market conducive to sustainable economic growth and stability. Within the framework of this directive, however, there was room for an increase in pressure on member bank reserve positions during the spring, as recovery in the economy had given way to expansion. On May 26, the directive was revised to provide that transactions should be undertaken with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities. Although this was the only change during the year in the language of the directive, there were occasions, as indicated in the entries for the individual meetings, when the directive was issued with the understanding that in the conduct of open market operations there would be a leaning on the side of restraint or of ease."

The following excerpt from the "Record of Policy Actions" covering the meeting on May 26, 1959 (pp. 44–45, 46th annual report), shows the factors taken into account by the Committee at that meeting in adopting a change in the policy directive to provide for operations with a view "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanded employment opportunities."

"Productive activity was spurting ahead and the economic climate had become distinctly more inflationary, according to reports at this meeting. Industrial production in April, which carried the Board's index up two points in a month for the third consecutive month, reflected principally gains in output of durable goods industries, including both producer and consumer lines. Data available for May suggested another two-point advance in the index for that month. Personal income had been climbing for several months at an annual rate of more than $3 billion a month, principally because of higher wage and salary payments. Reflecting this improvement in personal income, retail sales (seasonally adjusted) in April carried beyond the large March volume and were about 12 percent higher than the cyclical low point of March 1958. A robust expansion of consumer installment credit, which had been in process since late 1958, supported rising sales of automobiles and household durables.

"Housing starts in April, seasonally adjusted, were at the annual rate of 1.4 million, and the total of starts in the first 4 months of 1959 was the highest on record for a comparable period. Total construction contract awards in April had reached the highest level on record, 31 percent above a year earlier. Marked improvement in the employment situation also had occurred in April, and the unemployment problem appeared to be diminishing in scope to certain pockets of structural unemployment. Industrial prices rose further in April and an additional advance was taking place in May; at mid-May, the level was up 2.5 percent from a year earlier and stood 2 percent above the prerecession high reached in 1957. Consumer prices advanced slightly in April, with a further modest rise indicated for May.

"In financial markets, the month of May was characterized by unseasonably large credit demands and further increases in interest rates to the highest levels for some years. Nearly all interest rates rose except yields on 3-month Treasury bills, which continued in the 2¾ to 3 percent range that had prevailed generally since late February. Yields on long-term Treasury bonds and on both new and seasoned corporate issues had now risen to the highest levels since the 1920's. On May 15, large city banks announced an increase from 4 to 4½ percent in their in their lending rate on prime customers' loans.

"Following an exceptionally large increase in bank loans at all commercial banks in April, city banks showed a further loan expansion in the first 3 weeks of May. The increase had been particularly large in business loans, but real estate and consumer loans also showed marked increases. The ratio of total loans to total loans and investments of banks now stood close to the high level reached in 1957. The aggregate money supply, after adjustment for seasonal variations, showed an advance in recent months at an annual rate of 4 percent or more, and in addition the turnover of bank deposits had been increasing in recent months.

"The large May refunding and cash operations of the Treasury were now completed, and it appeared likely that no additional borrowing would be necessary until early July. Nevertheless, the expansion in credit demands during April and May had brought increased pressure on the reserve positions of banks, as indicated by the rise in borrowings at the Federal Reserve banks and the accompanying increase in the level of net borrowed reserves.

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"Upon review and analysis of the overall situation, including the continuing U.S. balance-of-payments deficit, the Open Market Committee reached the conclusion that the current level of restraint imposed by monetary and credit policy was not sufficiently restrictive and that an intensification of restraint was required. Reports presented by the Reserve bank presidents at this meeting indicated the possibility that the directors of the respective Federal Reserve banks would move soon to fix the discount rate at a level higher than the prevailing 3 percent—probably 3½ percent. On the assumption of a rate increase of no larger proportions, the Committee favored conducting open market operations with a view to exerting additional pressure as rapidly as that could be done without creating an untenable condition in the market for Government securities.

"Although the firmer tone desired by the Committee was not expressed in terms of a specific target of net borrowed reserves (an excess of member bank borrowings at the Reserve banks over their excess reserves), it was noted that additional restraint could be brought about in the next few weeks by letting natural factors take their course. On the basis of projections before the Committee as to factors affecting the supply of and need for reserves in the weeks ahead, it appeared that under such a procedure net borrowed reserves, which recently had been running in the neighborhood of $250 million, would move upward toward the $500 million level."

The factors considered by the Committee at the immediately preceding meeting held on May 5, 1959, are shown by the following excerpt from the "Record of Policy Actions" covering that meeting (pp. 42–43, 46th annual report).

"The economic report was one of strongly expanding demand, rising productive activity, advancing prices at wholesale, and strongly optimistic business and financial expectations. Labor market data pointed to further strengthening of demands for manpower, and altogether the domestic expansion in process was suggestive of developing inflationary boom. Internationally, a pickup of activity in key industrial countries and improvement in the balance-of-payments positions of material-supplying areas indicated that a general upturn in world output and trade was underway.

"Pressures on financial markets had increased during April, apparently reflecting expanding monetary and credit demands incident to the continuing advance of business activity rather than limitations on the supply of credit. Demands on long-term capital markets had been moderate, but bank loans (particularly consumer installment credit) had increased more than seasonally and banks also had been endeavoring to distribute Government securities taken on in the April 1 financing. Mortgage demands continued large and real estate loans at banks had increased more than at any time since 1955. The stock market had risen to new high levels and stock market credit continued to increase. Interest rates had continued to rise further. Reflecting these factors, member bank borrowings from Federal Reserve banks had risen in recent weeks to an average of around $700 million.

"Although the majority of the Committee agreed that it would be desirable to move toward greater restraint on credit expansion as soon as feasible after the current Treasury financing was completed, a minority point of view cautioned against a monetary policy that might defeat and finally counteract what could prove to be only normal economic growth by touching off a spiral of contractive credit forces. A specific danger cited was that undue restraint on the growth of the money supply could result in harmful consequences to the Government securities market if commercial banks were forced to liquidate unduly large amounts of securities in order to fulfill lending obligations to their customers."

* * * * * * *

The foregoing excerpts from the "Record of Policy Actions" in the annual reports, showing the evolution of policy thinking on the basis of the economic and financial developments during 1958 and 1959, points up the unlikelihood of an abrupt policy shift at a single meeting of the Committee. A reading of the entire "Record of Policy Actions" brings out even more clearly the need for analyzing policy decisions in terms of developments over a period of weeks and months.

Representative GRIFFITHS. I would like to ask you, however, you have already made it a little clearer to me, but you have pointed out——

Mr. ROUSE. Excuse me, Mrs. Griffiths, just reverting to your preceding question, I would just like it to be clear, I am sure it is, but I would like it to be clear, that the management does not institute a policy of restraint. The policy is provided to us by the Open Market Committee, and if they have, we will say, on the day of an Open Market Committee meeting changed from one degree of restraint to another, then we would change the degree of our operations to be consistent with the shift in policy. That is the only way that I see that I could do this, but I will make an effort, as I said, and file it.

Representative GRIFFITHS. All right.

As I say, I had a question, but you have already made it a little clearer to me, I did not understand why you said:

> It is my duty as manager of the account to make sure that the intentions of the Federal Open Market Committee as to the management of the account during the period between meetings of the Federal Open Market Committee are clear to me.

I would assume it was the duty of the Federal Open Market Committee to make sure that you know, and not your duty to make sure that you understand. Are they so ephemeral that you cannot understand what they are saying to you?

Mr. ROUSE. Would you mind saying that again?

Representative GRIFFITHS. Are the directions of the Federal Open Market Committee so vague that they are not easily understandable?

Mr. ROUSE. Mrs. Griffiths, they involve a great many factors which are diverse.

Representative GRIFFITHS. I see.

Mr. ROUSE. As I indicated in my statement, you start from as is, we start from now, and we are having a meeting of the Open Market Committee here, and we consider these various guides, such as rates in the market, we consider the degree of where bank reserves are, are they deficient or are they in surplus.

We consider the whole variety of factors. It is really quite an impressive presentation that is made to the Committee and which they, in turn, make to each other, the individuals on it, and so all these factors are considered at each meeting, but there are times, we will say, like last fall, when the international situation becomes, perhaps, more heavily weighted than at other times; all these factors are considered throughout the period, but you get into a degree of weighting the various factors. Precise measurements in terms of numbers is not really the kind of a guide that I would find as satisfactory as indicating a general degree or direction of restraint or ease, as the case might be, and the consideration of interest rates and the like.

Under these conditions we keep in close touch with the members of the Committee, and since they understand the movement of these various factors, we seem to get along pretty well in understanding each other.

Representative GRIFFITHS. But they do not give you only specific directions; you are empowered also to act on statements they have made, they may have made.

Mr. ROUSE. On the basis of the conclusions of the Committee as a committee, not on the basis of individual statements. That colors your views somewhat, but one has to go on the basis of the majority conclusion.

There are times when some people disagree with the majority. But one does not, in the operation of the account, work on the basis of the minority view.

If the minority is substantial, those views are taken into consideration by the majority in reaching the consensus that they reach and which I get.

Representative GRIFFITHS. If you act, and it is later determined that your action was an improper action, can you refer to on such and such a date such and such a statement was made by one of the members of the Committee, and "On this I based my action"?

Mr. ROUSE. I do not think I have ever had occasion to, Mrs. Griffiths.

Representative GRIFFITHS. There is no blame whatever happens?

Mr. ROUSE. There is no what?

Representative GRIFFITHS. There is no blame no matter what happens?

Mr. ROUSE. Oh, sure. There would be blame if I bungled the thing.

Representative GRIFFITHS. Does the blame attach to you or to the Committee?

Mr. ROUSE. It would attach to both, and I think primarily the Committee, in a sense, because the thing is of major importance, and that is why we have to keep so close. That is, the members of the Committee have to follow this so closely that it would be both of us who would get blamed. If it was a detail I could be blamed by the Committee, sure. But I have not had this problem.

Representative GRIFFITHS. Is this blame ever made public?

Mr. ROUSE. If it were a major blunder, of course, it would be public.

Representative GRIFFITHS. I would like to ask what you mean when you point out, "We believe it important that the interested public know as much as may properly be disclosed."

Would you give me an example of something in the past which would not have been properly disclosed?

Mr. ROUSE. In my view, at any time it would be improper to disclose what the current policy is.

Representative GRIFFITHS. Why?

Mr. ROUSE. Because it would generate expectations and presumably buying and selling in the market which otherwise would not take place; a reversal of the policy, if that should take place without any announcement or leakage, might be very harmful to a lot of people.

Representative GRIFFITHS. So there are people though who do know what is happening, are there not?

Mr. ROUSE. There are people in the System, a close group of conscientious, dedicated people, who work in this field, and who devote their lives to it, and they do a splendid job.

They work under an aura of dedication, if I may say so, which precludes that kind of thing developing.

We have not, in my time with the System and before it, the 20 years before it when I was a close observer of the financial scene in a private banking institution, I cannot recall, in our area of anything of this sort occurring.

Representative GRIFFITHS. You mean that there hasn't been anyone within the System who used the knowledge for his own benefit?

Mr. Rouse. Yes, with respect to Open Market operations.

Representative Griffiths. Thank you very much. My time is up.

Chairman Patman. Senator Pell.

Senator Pell. Thank you, Mr. Chairman.

Mr. Rouse, first, I must say I would agree with your thought that when you are discussing a Committee conclusion, it is probably much better not to have a tape recorder taking it down because very often it will inhibit discussion. A good rapporteur can get the spirit of what people intend to say and mean to say, whereas the written record often fails to fully catch the spirit of the views expressed.

Mr. Rouse. Thank you for that expansion of my thought.

Senator Pell. You talk about buying and selling. I was wondering if the occasion ever arose when you would be buying long-term and selling short-term or vice versa in the same market? What are the ranges in terms of both par and interest in which you would both buy and sell?

Mr. Rouse. Yes, there are times when we would—we might sell short and buy long or longer, generally not as a swapping operation.

Senator Pell. What would be the occasion for that?

Mr. Rouse. We did have occasion to do that last spring in connection with some assistance being given, we hoped, to the Treasury with respect to Treasury bills, where we were buying some longer bills, the so-called annual bills, and to make some leeway for it we sold a small amount of shorter bills rather than affect the reserve position at all.

Senator Pell. What would be the purpose, I am still a little confused?

Mr. Rouse. That was to acquire some of the bills that were maturing, as I recall, on July 15. These annual bills had been something of a weight on the market, and the Treasury was coming in to borrow, to refund those bills, and we thought we could give them some assistance.

Senator Pell. Could you also enlarge for a moment on the terms of interest in relation to the quantity that you buy and sell?

Mr. Rouse. That would apply more to—I do not think we have done anything of this sort. I cannot recall of doing anything of this sort in 1960 or for some time. Is it a case of buying, we will say, 1-year securities or selling 1-year securities and buying 10-year securities?

Senator Pell. No. I was thinking in terms of the general, say, the level of the last 12-month period, what would be the state of the market for the long-term securities, we will say, which you would start to sell and buy?

Mr. Rouse. We do not do it for interest rate purposes. We do it for reserve purposes, to put reserves into the market or to withdraw reserves, so that the interest rates in that sense would not be a factor.

Senator Pell. Let us say Government paper was running at 90; would you tend to start to buy, to go into the market then?

Mr. Rouse. No, that would not be a concern.

Senator Pell. It would not?

Mr. Rouse. The problem is reserves, that is, our primary function is to carry out the insertion and withdrawal of reserves, with a view of the banking position.

Senator Pell. So you would try to divorce your operation from the market price of the securities?

Mr. ROUSE. In the sense that you are speaking of; yes, sir.

Senator PELL. Right.

Now, in conclusion, I find I am still a little confused in my own mind as to what is the basic objective of the open-market operation. Is it the point you mentioned earlier, to prevent a flow of currency from going abroad? What, basically, is it?

Mr. ROUSE. The basic operation is that of the insertion or withdrawal of reserves to affect the ability of the banks to invest or lend, lend and invest; that is the primary function, I should say.

Senator PELL. You would have the banks always in position so that they can lend?

Mr. ROUSE. Yes. In other words, if you are having an easy situation such as you are having now, where the banking position has more than adequate reserves, if you will, or having reserves which they are not using, there are excessive reserves over and above any borrowings which they have, perhaps 400 or 500 millions of free reserves, the banks are in a position where we hope they will go out and seek loans, good loans, not bad loans, but go out and seek loans; and also, as far as investments are concerned, the existence of these free reserves encourages them to utilize the money. They are private institutions operated for profit and, generally speaking, they do not allow their funds to lie idle. They either invest them or lend them.

Senator PELL. Thank you, sir. That is all.

Chairman PATMAN. Mr. Rouse, I wanted to ask you about making these decisions public. You heard, in my opening statement, that I mentioned the fact that the Federal Reserve Board—which represents the public—announce decisions on discount rates, on margin requirements, on lowering or raising reserve requirements, and things like that at the time the decisions are reached. They announce them immediately.

Now, the other body I referred to in the opening statement was, of course, the Open Market Committee. What real harm would be done to announce its decisions as they are made, just as the Federal Reserve Board announces its very important decisions when they are made.

Mr. ROUSE. My view is that there is risk in doing it.

Chairman PATMAN. Risk in doing it. Risk to whom?

Mr. ROUSE. To all interested people.

Chairman PATMAN. Interested people?

Mr. ROUSE. Yes. To make expectations that would not be borne out. This is a subject that you would discuss, perhaps, with my associates tomorrow, and excuse me.

Chairman PATMAN. I see; yes, sir. But now, isn't it the fact that when you begin to operate under these vague, indefinite decisions no one knows exactly what you are going to do until you begin to act, and then, as you begin to act, sophisticated people in the trade and the money market business know immediately, but the people in general do not know; isn't that a fact?

Mr. ROUSE. Over time, from the figures that are given out in the weekly statements, I think a very——

Chairman PATMAN. That is the result?

Mr. ROUSE. It is possible for everybody——

Chairman PATMAN. Well, you said that a while ago.

Mr. ROUSE (continuing). For everybody to know.

Chairman PATMAN. Yes.

Mr. ROUSE. And this is gradually revealed through the figures. But there are times when I think it could have a really adverse effect. If the Committee were to appraise the economic situation of the country as in a clouded area, if you will, and wanted to do some operations, effect some operations, either insert reserves or withdraw them to try to see what the effect would be before really making up their minds, you could not do that kind of thing and make a statement——

Chairman PATMAN. I want to suggest that question for the consideration of your Committee tomorrow and see if they cannot come up with something that would give the public the benefit of more information than they are now getting, because it looks like a discrimination against the public interest.

The people in the trade and the business know what it means; they have watched this thing over the years and for decades and they know exactly what you are going to do; they can profit from it, and yet the public, generally, is ignorant of it. They are not informed until long after it is actually passed. It occurs to me in the interest of the public that you should do more like the Board of Governors. However, I recognize that the Open Market Committee are not all public members.

On the Open Market Committee you have seven members of the board of governors who are supposed to represent the public, and I assume they do, honestly and faithfully.

But the other five members of the Open Market Committee sit in there and participate just like the seven board members.

Mr. ROUSE. That is right.

Chairman PATMAN. These five express themselves and you have said you put their views down and you consider them, and in arriving at the conclusion you will come to as to what these vague words of the directive mean.

Now, every one of these five presidents of the Federal Reserve banks has been elected by a board of directors, six of whom, out of the nine, are elected by the private banks, whose duty it is to see that they make a profit. I want to see a profitable banking system myself—I am all for that.

But these five presidents have more of a private, profitmaking, almost a selfish interest, as compared to the public members. The public is, therefore, required to accept the judgment of people who have an ax to grind. What do you have to say about that?

Mr. ROUSE. I have this to say: You refer to the seven members who are not—seven presidents who are not members of the Committee and being present and having their say. They do have their say and it is considered by the seven members of the board and the five presidents who make up the Open Market Committee, and that is considered in their final conclusion.

What I have to consider is what is the opinion of the 12, people who make the record. That is the Open Market Committee, not the 19.

Chairman PATMAN. But, Mr. Rouse——

Mr. ROUSE. Yes, sir.

Chairman PATMAN (continuing). I think Congress made a terrible mistake when it allowed representatives of private banks to be on these policymaking boards that fix the interest rates and the supply of money and things like that. But Congress did it. The House did not do it. The Senate put it in, and they agreed to it in conference way back there.

I cannot understand, when the Congress said this Open Market Committee will be composed of 12 members, and gave it more power than any board on earth has ever had—more today than Congress itself has to affect the economy of the country—and said that the Committee shall be composed of 12 members, 7 of whom shall be members of the board of governors, and 5 presidents of Federal Reserve banks, why the will of Congress is disregarded.

Of course, I am not charging you personally with it; you are just working for them.

But it is disregarded when they bring in all 12 of the presidents, each one of them having a private ax to grind. It looks to me like that is going against the will of the Congress.

It is bad enough to have the people representing a private banking interest on there at all, but when you double up and have 12 of them to overwhelm the 7 public members, it looks to me like it is against the public interest.

Mr. ROUSE. Of course, I beg leave to disagree with you with respect to your term of the private interest on the part of the presidents of the Federal Reserve Banks in the country. They are not private individuals in the sense that you mean.

Chairman PATMAN. Well, they were selected by the private bankers as representatives of the private bankers, and we assume they were looking after their interests. I am not assuming they are doing anything wrong, and I am not charging them with any wrongdoing, but I am just talking about the interest of those who elect them.

You said a while ago that you had never known anyone to profit from the information he had about the operation of the Open Market Committee. Well, I have not either. At the same time, we have not investigated the Open Market Committee, and I will assume that there is no dishonesty, but there is no law or regulation against people who have this knowledge actually speculating in the Government bond market, is there? You have no regulation against it?

Mr. ROUSE. There is no law——

Chairman PATMAN. You have no law against it.

Mr. ROUSE. We have no law or regulation, and we have advised you from time to time of the very careful selection of people, and the effort we make to bring to their attention what, for example, Congress produced last year, was it, or the year before, in the matter of ethics. Also our people understand that if there is any participation in the Government securities market on the marketable side, of course, not the savings bonds, that they are subject to immediate dismissal, and we bring this before this group, like myself and Mr. Marsh and Mr. Stone and our associates in the operation annually.

We make sure they read it and understand it.

Chairman PATMAN. But there is no regulation against it, no law against it, and I think that Mr. Hayes stated, in answer to one of the questions I asked him a year or two ago, that it would be all right for

people in the Federal Reserve to buy Government securities, as long as they did not buy them on margin. Do you recall something like that?

Mr. ROUSE. No; I do not, but I would not have any quarrel——

Chairman PATMAN. I think I am correct. I would not want to misquote him, so I will ask him about it tomorrow.

Mr. ROUSE. I would not have any quarrel with the chap working in the check function who did not have anything to do with the open market function or any knowledge of it, buying Government securities in the market.

I would have some quarrel with him, I think, if he was subscribing to new issues of Government securities that happened to be hot.

Chairman PATMAN. Let me see if I understand you correctly.

You say it would be all right for your people in the Federal Reserve to buy in the open market Government securities, although you have some knowledge that other people do not have?

Mr. ROUSE. No; I did not say that; excuse me.

Chairman PATMAN. You did not say that.

Mr. ROUSE. I did not say that. I said there were people working in areas in the Federal Reserve System who had no knowledge of or contact with this end of the business.

Chairman PATMAN. I see.

Mr. ROUSE. And who might buy five bonds or something like that certainly, inherited something——

Chairman PATMAN. I want to ask you about these notes. You have elaborate notes that you make at each one of these meetings, of course. Now, it is possible we will want to see some of those notes. Will you make them available to us?

Mr. ROUSE. I will discuss it with the Committee, sir.

Chairman PATMAN. What is that?

Mr. ROUSE. I will discuss it with the Committee.

Chairman PATMAN. Well, you mean you are not willing to say that you will let us see them?

Mr. ROUSE. No, sir.

Chairman PATMAN. You have to discuss it with the Open Market Committee?

Mr. ROUSE. I would.

Chairman PATMAN. You are working for them.

Mr. ROUSE. These are the minutes, in effect, of the Committee.

Chairman PATMAN. Very well.

Mr. ROUSE. That is a subject, if you would, sir, please to take it up with Chairman Martin.

Chairman PATMAN. Well, suppose you—no; I am going to take up another one with him. He has got notes, too, that I want. [Laughter.]

Anyway, we will not try to embarrass you by asking you for a decision, but you let us know in the next 2 or 3 days, if you will, as to whether or not you will let us have those notes, because we might have a process by which we might get them anyway. We do not know, we do not want to resort to that.

Representative REUSS. Will the chairman yield? I take it the chairman is talking about the formal minutes of the Open Market Committee and not merely some fugitive or haphazard notes that are lying around?

Chairman PATMAN. No; the minutes that he himself uses in the Federal Reserve Bank, New York, where he has charge of open market account for the Open Market Committee, and which he uses for the purpose of helping him to arrive at the right decision concerning the language in a directive.

Mr. REUSS. These are the minutes of the Committee.

Chairman PATMAN. Yes, sir; the minutes of the Committee.

Mr. ROUSE. The minutes of the Committee that I use.

Representative REUSS. As I understand it, the witness is not going to let Congress see—it sounds incredible to me, and I want to be sure that he did say it.

Chairman PATMAN. I do not want to force a decision from him now because he is going to the Open Market Committee tomorrow, and he can get their judgment about it and, of course, let us know. If he cannot furnish them, then we will have a discussion about it to see if there is another way of getting them.

Representative REUSS. If the chairman would yield I would communicate to the witness my strong personal view that the Open Market Committee which is a public body, has no right whatever to hide from the people and the U.S. Congress its formal minutes of action taken and that, I think, it is outrageous that there is any question about it, and I propose to pursue the matter. These are minutes a year old; we are not talking about anything current.

Chairman PATMAN. I expect to ask Chairman Martin for the minutes of the Board tomorrow when he appears tomorrow before this committee.

Senator BUSH. Mr. Chairman, I would simply like to say that I think Mr. Rouse is absolutely correct in not agreeing to give this committee the minutes as requested by this committee. He hasn't got the right to do that. He is a servant of this Open Market Committee, he is employed by them, and the matter of whether they release their records to this committee is for them to decide and, certainly, I do not think that Mr. Rouse can render a decision before this committee.

Representative REUSS. I simply want to convey to him my feelings in the matter that the Open Market Committee ought to make those minutes available.

Senator BUSH. I have no doubt that this Open Market Committee, upon request of this committee, properly delivered officially, would give the request serious consideration. I have no doubt about it. I do not think they have got anything to conceal about their operations. In due course we all know what happens after a decision is made anyway, so I commend Mr. Rouse for his position.

Chairman PATMAN. Let us make it plain, Senator, we probably will ask him for his own minutes made up at and after each Open Market Committee meeting, which he uses in order to determine the meaning of the formal directive that he receives from the Open Market Committee. We are not asking him for the Open Market Committee minutes, and we do not intend to. We intend to ask Mr. Martin for them.

Mr. ROUSE. They are one and the same.

Senator BUSH. He is an employee of the Committee, and the bank is his boss and, obviously he has got to go to them and ask them whether he can release any material.

Chairman PATMAN. We are not pushing him.

Senator BUSH. I should hope not.

Representative WIDNALL. Mr. Chairman, might I ask this question?

Senator BUSH. I yield to you.

Representative WIDNALL. Thank you very much for yielding.

Wouldn't this tend, if disclosed to the public, and studied by speculators who understand the inner workings of the minds of those serving on the Open Market Committee, get them to go in and speculate more and more in the securities market? Actually one of the greatest functions which Federal Reserve performs, in my mind, is to make a decision and by not disclosing why they made the decision, keep a much better balance within the market.

Chairman PATMAN. May I suggest the other side of the coin is that by keeping it secret certain people know what they mean the very minute they put it into effect; by actions they can judge exactly what is happening. They can profit by it.

But the other people, the public, generally, does not know. My idea is that everybody should know it just like when the Federal Reserve announces that they are going to lower rediscount rates, or they have changed the reserve requirements, or anything like that.

Senator BUSH. Well, Mr. Chairman, it seems to me that the Open Market Committee, with possibilities like this, has got to judge time of release of important information that affects the money market or the stock market. Accordingly they try to decide to do it in a way and at a time when all concerned—and this means the whole public—have an equal chance to benefit or be injured by the information.

If, for example, the margins are going to be reduced from 80 percent to 70 percent, it would seem to me to make a mistake to announce it 20 minutes before the market closed when those who happened to be there might bargain with it to their own private advantage. If they announced it after the market closes, then everybody has overnight—12 hours or more—to consider it.

Chairman PATMAN. May I ask Senator Bush about the meeting, should we conclude this morning? I have to go to the floor pretty soon, or should we have an afternoon session? What is the pleasure of the committee?

Representative REUSS. I have some more questions, Mr. Chairman.

Senator BUSH. Mr. Chairman, so far as I am concerned, I am finished, and I do not require any more time, and I would be glad to have this continue as long as Mr. Reuss has questions or the others too, but I would suggest we do not come back after lunch.

Senator PELL. I do not have any further questions.

Chairman PATMAN. Mr. Reuss has, I know.

Representative REUSS. I think we can finish up, however.

Chairman PATMAN. You mean now?

Representative REUSS. It depends on whether the Chair and Mr. Widnall have some questions.

Chairman PATMAN. Would you preside then and let me go to the floor? You go right ahead.

Senator BUSH. Would you excuse me? I must go, I am sorry; I would like to hear your questions, but I am afraid I will have to excuse myself, too.

Representative REUSS (presiding). Mr. Widnall?

Representative WIDNALL. I do not have any questions.

Representative REUSS. Mr. Rouse, I think you testified before that the Open Market Committee had not bought any Government securities in 1960 with a maturity of more than 15 months; is that correct?

Mr. ROUSE. That is my recollection.

Representative REUSS. I would like to have you straighten me out on a matter that appears on page 116 of the annual report, if you will find that page, table No. 3.

There is an indication to me that during 1960 there was purchased for System account $2 billion worth of Treasury notes maturing in November 1964, in other words, 5-year notes. What about it?

Mr. ROUSE. That was a transaction direct with the Treasury. They were not purchased in the open market. That was the decision of the Committee to make an exchange with the Treasury.

Representative REUSS. I know that the year before, in 1959, $2.642 billion of 1964 notes were purchased. Was that also a direct purchase from the Treasury?

Mr. ROUSE. Yes.

Representative REUSS. Now, is it not a fact that ever since the adoption of the basic policy of the Open Market Committee in 1953 that with the exception of action taken to correct disorderly markets, the kind of action that was taken in July 1958, in fact, the purchases have been confined to bills, securities of 90 days and less; is that not so?

Mr. ROUSE. No; that is not so. We had purchased some certificates and notes, as I recall, and I think had sold some as well. We also bought 1-year bills.

Representative REUSS. What maturities were left to those certificates and notes since 1953, leaving outside the disorderly market collection?

Mr. ROUSE. I do not—I cannot answer that offhand, Mr. Reuss.

We also bought bills maturing a year hence, the 1-year bills, through bidding in the auction, in exchange for maturing bills.

Representative REUSS. Now, on page 48 of the report it sets forth that in the March 22, 1960 meeting Mr. Hayes voted against reaffirmation of the operating policies in their existing form, since he felt that the Committee should not take any action which would voluntarily tie its hands, and should not create the impression of an excessively rigid approach to open market operations. You recall that statement?

Mr. ROUSE. Yes; I have it here.

Representative REUSS. I have difficulty squaring that description of what went on at the meeting and the representations made by Mr. Hayes with what you tell me: that the so-called bills-only policy which was in effect from 1953 until quite recently did not really mean bills-only at all, except for disorderly conditions, but meant 5-year securities and less, which is a vastly different thing.

I am just wondering whether Mr. Hayes was really flexing his muscles against a policy that said, "Anything under 5 years is all right for purchase," or whether he was not, in fact, directing his attack at what all the world, I must say, thought was the Open Market Committee's policy, a policy, by and large, restricting itself to 90-day securities.

Can you explain that a little?

Mr. ROUSE. I think I have already straightened the record as far as this 5-year matter you speak of, by saying that the current—that the definition of the Federal Open Market Committee as far as short-term securities is concerned is 15 months.

I will not attempt to speak for Mr. Hayes with respect to this. This is his matter and a policy matter as far as he is concerned and, as Vice Chairman of the Committee. The policy of the Committee has been short-term securities, and there have been occasional times when we have operated at other than 90-day bills. We have operated in short-term bonds, notes, and certificates, but all having a life left of less than 15 months.

Those operations have been minor.

Representative REUSS. So that from 1953 on the policy directive of the Open Market Committee, which was, in verbal terms, prohibition on dealing in other than short-term securities, was, in fact, mainly construed as a directive to deal in 90-day securities, although on occasion there were excursions into slightly longer term securities up to 15 months.

Mr. ROUSE. By and large, Reserve objectives can be achieved most easily and with the least effect, I believe, in Treasury bills. I would not confine it necessarily to the 90-day bills, but in Treasury bills it is the medium which a great many of the large institutions particularly use for the purposes of adjusting their reserve positions, and also they represent securities which the dealers hold in substantial volume, and which our large nonfinancial corporations hold in sizable volume, and it makes for, by and large, a smooth operation, in effecting large changes in reserves.

Representative REUSS. But it is also your testimony that you construed the words "short-term securities" to mean securities of 5 years and under.

Mr. ROUSE. At times I do. The last time that I discussed this with the Committee, I believe I recommended that if short-term securities were to be defined that they be defined as securities maturing within 2 years.

Representative REUSS. In other words, you wanted your interpretation of the Committee's mandate altered?

Mr. ROUSE. Yes.

Representative REUSS. You thought it meant 5?

Mr. ROUSE. No, excuse me, I did not. I understood it clearly that it was 15 months, and I thought that a sounder interpretation of a short-term security as at the time we were discussing it was 2 years. I have forgotten just when it was.

Representative REUSS. And now, that short-term language we are talking about has been corrected by a subsequent Open Market decision, has it not?

Mr. ROUSE. We are still confined to on repurchase agreements to 15 months, and I would say that is the general—I would not go beyond 15 months in buying short-term securities. I am sure that would be the temper of the Committee, and I would not proceed beyond that without consulting the Committee.

Representative REUSS. But the language in the 1953 policy statement which we have been concerned with here this morning, namely,

that operations for the system account of the Open Market shall be confined to short-term securities, that has now been repealed, has it not?

Mr. ROUSE. That is getting into this year, if I may be excused.

Representative REUSS. It was not repealed as of December 31, 1960?

Mr. ROUSE. No, sir, right.

Representative REUSS. And, therefore, until it was repealed this year, if it was, and I assume it was because it is a matter of public record that 8- or 9-year maturities have been purchased?

Mr. ROUSE. Yes, 8 or 9 and beyond 10 years have been purchased.

Representative REUSS. Beyond 10 years.

I assume it has been repealed, but it was not as of December 31, 1960, so that the rule in force from 1953 through December 31, 1960, and——

Mr. ROUSE. Except for disorderly markets.

Representative REUSS. Except for disorderly markets, and except for such changes which may or may not have been made in 1961, and which we will find out about next year, the rule was that you were not to purchase or deal in——

Mr. ROUSE. Other than short-term.

Representative REUSS (continuing). Securities of not more than 15 months remaining maturities.

Mr. ROUSE. Of other than short-term securities, and the Committee could define that to suit themselves, of course. But the general interpretation by the Committee was 15 months.

Representative REUSS. 15 months; and it was that from the beginning of 1953 through 1960, at least, the period we are talking about?

Mr. ROUSE. I will put it this way, Mr. Reuss, because I do not recall there has ever been a formal resolution saying that this is 15 months or some other months, but certainly the management of the account has taken the position that it would not buy securities longer than 15 months in the ordinary course without coming back to the Committee for discussion. So that there is a general understanding that 15 months would be the limit.

Representative REUSS. This understanding was not embodied in any formal resolution?

Mr. ROUSE. No formal resolution; that is why I am putting it the way I have.

Representative REUSS. Yes. On October 25, 1960, the earlier directive was amended to add the words that you should take into account "current international developments." This is on page 67. Is that a correct statement of the action taken?

Mr. ROUSE. Yes; and I might say with respect to that, Mr. Reuss, that you will see, if you follow the thread through the annual report of these meetings, that you will find that more weight began to be given to the international side back in, I guess, June or July meetings, although it had come in to May, as I said before. All through, it is always taken into consideration, but with the change in conditions that developed in the summer, as you will recall, more and more weight was given to this factor, and it really reflected the recent, in terms of October, developments in the international market.

Representative REUSS. How do you give weight to the factor of current international developments; by what actions?

Mr. ROUSE. The difference in interest rates between our domestic market and certain foreign markets was widening at that time, as I recall, and we expected to have to put considerable reserves into the market in the forthcoming period, the next period of 3 or 4 weeks, and we did two things: We put emphasis on buying securities beyond the 90-day period, in buying certificates and notes and possibly some things like the 2½ percent bonds of November 1961, in order to take some of the pressure off the short-term market that otherwise would be there, that is, take the pressure off the Treasury bill market which is regarded abroad, as you know, as the key short-term market.

Representative REUSS. But still within the 15 months' limitation.

Mr. ROUSE. Oh, yes. At that time, if you will recall, bills were tending to go at 2⅛ percent.

We also did another thing, which was this: The day following that meeting, I think it was, the Board of Governors announced the release of a large amount of reserves through changes in vault cash and reserve requirements to become effective November 24 and December 1 following; and this meant quite a complicated problem for the management of the account in providing the reserves that were necessary between that time, October 25 and 26 and these dates in the future, 5 weeks ahead and, at the same time, not have a tremendous redundancy of reserves which would develop if funds had been put in on a permanent basis.

So efforts were made to buy short term, the really quite short securities, and also to lend on those securities to the dealers. The dealers were acquiring large amounts of Treasury bills anticipating bank investment with the release of reserves.

So we were able to insert a considerable volume of reserves in the form of purchases against resale contracts with the dealers, and so withdraw a portion of those funds at the time that the release of the reserves, as announced by the Board, by changes in the regulation, happened.

Actually we left more reserves in than statistically we might have thought necessary, because we found it difficult to determine how quickly the reserves that became available through the release of vault cash offset by a 1-percent increase in reserve requirements of country banks, would be utilized, so that if you looked at the record you would find that free reserves were averaging in the neighborhood of $600 or $700 million in the period of, we will say, the second half of November into the second half of December.

Representative REUSS. Now, the first action taken following the October 25 directive was to extend the range of buying from the 90-day range which you had been operating under into something longer; is that not so?

Mr. ROUSE. Yes.

Representative REUSS. And this was taken, I believe you testified, because of the disparity between interest rates in this country and interest rates abroad, which was causing, in your view, the departure of certain short-term capital from this country going abroad attracted by a higher short-term interest rate abroad.

Mr. ROUSE. It was a factor in that departure.

Representative REUSS. What you were doing was trying, consistently with a given decision on the amount of reserves you needed to

create in the banking system for general monetary purposes, you were trying to purchase somewhat fewer very short terms, and somewhat more, somewhat longer terms, but still, of course, within the 15 months.

Mr. ROUSE. Somewhat longer short terms.

Representative REUSS. Somewhat longer short terms.

Mr. ROUSE. Yes.

Representative REUSS. And the purpose for doing that was to decrease the discrepancy in the interest rate here vis-a-vis abroad; was it not?

Mr. ROUSE. It was an attempt to reduce the volume of flow of funds abroad.

Representative REUSS. Yes.

By decreasing the discrepancy in the interest rate.

Mr. ROUSE. This we thought would be a factor.

Representative REUSS. That is a very clear account of what you did, and as far as I am concerned, a very admirable approach to the realities of the situation. However, I have difficulty squaring your account of what you did with the statement which I thought you made earlier that you do not operate to affect interest rates.

It seems to me this is precisely what you were trying to do. You did it; it did some good. It did not harm, and it somewhat invalidates the philosophical point you made earlier.

Mr. ROUSE. Yes, it has that difficulty, but the end purpose to be served was not to maintain an interest rate, but to reduce the volume of funds moving abroad.

Representative REUSS. But you have said that——

Mr. ROUSE. Can we leave it that way?

Representative REUSS. Here we go again.

You said it was to be done by operating on the interest rate. So can't we conclude this session in an atmosphere of intellectual harmony by saying that, in fact, you do operate on interest rates, that there is nothing un-American about it, that you should be proud of doing it and, of course, admit it?

Mr. ROUSE. I think anything we do in our field has to be reflected in interest rates, sir; yes, sir.

Representative REUSS. Thank you very much, Mr. Rouse. I appreciate your coming here and your very able discussion.

I want to thank your associates, too.

We will now stand adjourned until 10 o'clock tomorrow morning in this room, at which time we will hear first Mr. Hayes, and later on, Mr. Martin.

Thank you very much.

(Whereupon, at 12:20 p.m., the committee recessed, to reconvene at 10 a.m. on Friday, June 2, 1961.)

REVIEW OF ANNUAL REPORT OF THE FEDERAL RESERVE SYSTEM FOR THE YEAR 1960

FRIDAY, JUNE 2, 1961

Congress of the United States,
Joint Economic Committee,
Washington, D.C.

The joint committee met, pursuant to recess, at 10 a.m., in room 1310, New House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, Boggs, Griffiths; Senators Proxmire, Pell, and Bush.

Also present: William Summers Johnson, executive director.

Chairman Patman. The committee will come to order.

The Senate is meeting this morning at 10 and taking up the housing bill. Some of the members on the committee have an interest in the bill before the Senate, and obviously they will not be able to be here because they have already agreed on a time limitation for debate on consideration of the bill, and it will be necessary for them to stay rather close to the Senate floor. For that reason it will be necessary for us to proceed.

Now, Mr. Hayes, we are glad to have you as a witness, sir.

You have a prepared statement, I believe?

Mr. Hayes. Yes, sir, I have.

Chairman Patman. You may proceed any way you desire.

STATEMENT OF ALFRED HAYES, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK, AND VICE CHAIRMAN, FEDERAL OPEN MARKET COMMITTEE; ACCOMPANIED BY JOHN J. CLARKE, ASSISTANT GENERAL COUNSEL; AND GEORGE GARVY, ADVISER, RESEARCH DEPARTMENT

Mr. Hayes. May I introduce my associates here, Mr. Patman?

Chairman Patman. Certainly. Please identify them for the record.

Mr. Hayes. Mr. John J. Clarke, Assistant General Counsel; Mr. George Garvy, adviser in the Research Department.

You know my name. I am the President of the Federal Reserve Bank of New York, and a member of and Vice Chairman of the Federal Open Market Committee. You have asked me to appear before you as a witness in this hearing, which I understand is to focus mainly on questions suggested by the record of policy actions of the Federal Open Market Committee contained in the annual report of the Board of Governors of the Federal Reserve System covering op-

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erations for the year 1960. I am glad to have this opportunity to appear before the committee to discuss some of these points, and possibly to assist the committee in respect of particular matters that concern it.

As Mr. Rouse stated when he appeared before you yesterday, the Federal Open Market Committee has selected the Federal Reserve Bank of New York to carry out all transactions in U.S. Government securities for the account of the 12 Federal Reserve banks. The selection of the Federal Reserve Bank of New York is the logical consequence of its physical location in the Nation's money market center, where the great bulk of all transactions in Government securities, and in other money market instruments, actually takes place. The securities acquired pursuant to such operations are held in a system open market account in which the 12 Reserve banks participate.

The general position of the Federal Open Market Committee as to credit policy is set forth in the directive it issues to the Federal Reserve Bank of New York at each meeting. Each directive is amplified by the statement of the consensus of the Committee and by the full discussion of the participants in the meeting, all of which are noted in the minutes of the meeting.

The primary responsibility for the conduct of day-to-day open market operations rests with the Federal Reserve Bank of New York, acting in accordance with the directions of the Federal Open Market Committee, whose members are kept currently informed of these operations. Within the bank, this responsibility is centered in the manager of the System open market account. The manager has the advantage of frequent consultation with the President of the bank, who is a member of the Committee, with the First Vice President of the bank, who is an alternate member of the Committee, and with a staff in constant touch with the market. All of them have an incentive to keep continuously informed and to be readily available for consultation because of the institutional responsibility which they share. This sharing of responsibility has the additional advantage of permitting an internal arrangement whereby, in the absence of the manager, the First Vice President acts as his alternate in respect of open market operations.

In his statement yesterday, Mr. Rouse referred to the fact that the Federal Reserve Bank of New York, as fiscal agent of the United States, executes transactions in Government securities for the Treasury Department and that the bank also conducts similar transactions in behalf of foreign central banks and certain international organizations. These transactions, which are conducted under the general supervision of Mr. Rouse in his capacity as vice president of the Federal Reserve Bank of New York, affect member bank reserves and thus are relevant to, and must be closely coordinated with, System policy. The conduct of such Treasury and foreign transactions by the New York bank enables the manager and his staff to be informed as to their potential market impact and thereby to achieve, where desirable and possible, a closer integration of such transactions with the aims of System open market operations. As Mr. Rouse mentioned, it is at times possible for us to avoid an undesirable market impact of foreign account transactions by arranging transactions among those accounts or directly with the System open market account. The fact

that the Federal Reserve Bank of New York, as an institution, acts as fiscal agent of the United States, and serves as correspondent bank for foreign central banks, monetary authorities, and international organizations greatly facilitates the carrying out of the objectives of the Federal Open Market Committee.

I understand that you are particularly interested in the subject of the adequacy of the information provided by the Federal Reserve System, especially with reference to the record of policy actions taken by the Federal Open Market Committee. I assume that you would like me to comment first on the adequacy of the information in the annual report of the Board of Governors that pertains to the record of policy actions of the Open Market Committee.

The policy record of the Federal Open Market Committee, which is published each year as part of the annual report of the Board of Governors, records all formal actions taken at each of the meetings of the Committee. The directive to the Federal Reserve Bank of New York is given in full, together with the names of all members voting for or against its continuation or change, as the case may be, at each meeting. Furthermore, the consensus arrived at is recorded, and the considerations leading to it are summarized in some detail.

When decisions are not unanimous, the views of the minority are presented and occasionally it is also indicated what changes in the test of the resolutions adopted would have made it possible for the minority to vote for them. The secretary circulates the draft of the policy record to all members of the Committee in order to assure the presentation of a comprehensive and fair picture of our deliberations.

I believe that the Board's report, including the Federal Open Market Committee policy record, presents in an effective manner a comprehensive record of steps taken as well as a review of the underlying rationale. Students of monetary affairs have found this to be a valuable report.

The policy record is published once a year in the Board's annual report, as required by law. It has been suggested that the policy record be published more frequently. It has been pointed out that under present practice the record of the last meeting of any year becomes available with a delay of only about 3 months, while about 15 months elapse between the first meeting of any year and the publication of the record of that meeting in the annual report; and it has been suggested that the policy record could perhaps be published quarterly, with an appropriate lag. This possibility has been raised within the System. While I can see merit in the suggestion for quarterly publication under some circumstances, I would emphasize that the Federal Open Market Committee has not yet considered the matter in detail. I am sure that the Federal Open Market Committee would wish to avoid any hasty conclusions on this matter, in view of its importance.

I should not like to leave this subject without pointing out that students of monetary matters, and all those who must make decisions in credit and capital markets, follow closely the wide range of weekly and other periodic banking statistics published by the System, including the recently inaugurated release of data on U.S. Government securities markets, a matter concerning which your Committee has shown great interest. A timely and comprehensive review of business and credit conditions is available in the various monthly publications of

the Federal Reserve System, including our bank's Monthly Review, which carries each month a very detailed analysis of the credit and securities markets with particular attention given to U.S. Government securities and to Treasury financing operations. In addition to this material, which is written for those who closely follow current financial developments, we make an effort to provide less technical material, dealing with System functions, operations, and policies, designed to be of interest to a much wider segment of the public.

I should like to address myself now to the first of two related questions in which I understand the committee is interested, that is, whether monetary policy can be determined for longer periods in advance, and made public. It must be understood in this connection that an effective monetary policy requires a continuous review and reassessment of the evolving business and credit situation, both domestic and international, in which there must be a prompt and sensitive reaction to the interplay of factors affecting the development of policy. As you know, the Federal Open Market Committee generally meets every 3 weeks for a full-scale review of these matters, and special meetings can be called on short notice. Monetary policy has the major advantage of a high degree of flexibility—an advantage that would be lost if it became a practice to determine and announce policy intentions for long periods in advance. Fiscal policy does not, generally speaking, enjoy the same degree of flexibility. There would clearly be no wisdom in reducing the flexibility of overall economic policy by making monetary policy less sensitive and less adaptable to changes in the business and credit situation.

The second related question in which this committee has evidenced an interest is whether it would be advisable to make a prompt announcement of policy decisions. In response to this question, I could say that theoretically it would be possible for the Federal Open Market Committee to make an immediate announcement following each meeting as to the policy it had adopted. In practice, however, such public announcements would seriously interfere with the effectiveness of monetary policy. For example, business and credit conditions may at times be so clouded that the Federal Open Market Committee may wish to undertake a modest shift in the extent or direction of its operations and then evaluate the effect on credit conditions and on the money market. Depending upon the results, this shift might develop into a full-fledged move, or might be quickly reversed. The usefulness of such operations would be destroyed if the market were informed as to what was being attempted. Moreover, an announced shift in System policy might set off a wave of optimism—or pessimism—which, in turn, might result in substantial changes in security prices and yield. If somewhat later the System found it appropriate to reverse policy and made a public announcement to this effect, an opposite swing in market sentiment would be quite likely. In other words, a policy of prompt announcement might subject financial markets to disruptive swings in prices and yields which would serve no useful function. Conceivably such a policy might introduce an unnecessary and unwarranted degree of rigidity into System actions for fear of the very swings just mentioned.

I have now come to the end of my prepared statement, Mr. Chairman, and I shall be happy to answer any questions I can that the

members of this committee may have relating either to matters that I have covered or to any other matters with which this committee is now concerned.

Chairman PATMAN. Thank you very much, Mr. Hayes. We will avail ourselves of the opportunity of asking you some questions, if you please.

In your report of 1960, and I am certainly glad we are privileged to receive it earlier this year than we have in the past, and we compliment the Board on making it possible, at page 41, there is a reference to your policy decision of March 1, 1960, and you state there that open market operations should be conducted with a view to—

> fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion.

Then you say:

> This replaced the clause of the directive that had been in effect since May 26, 1959, calling for operations with a view "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities."

Just what difference do you see in the two, Mr. Hayes?

Mr. HAYES. Well, I see a considerable difference.

The May 26, 1959, directive, as you can see, put the first emphasis on restraining inflationary credit expansion. It was adopted at a time when pressures were very great in the credit markets, and there was a general fear of excessive credit expansion and possible inflationary developments.

The directive adopted on March 1, 1960, while keeping an eye on this possibility of excessive credit expansion, relegated that to a subordinate clause, and put the primary emphasis on the growth aspect.

Chairman PATMAN. Now, as manager of the account, if you had been manager of the account instead of being president of the bank, could you have taken that just by itself and interpreted as to what the Board actually meant?

Mr. HAYES. I do not think a manager would ever be expected to interpret the directive as a sentence without the full context of all the discussion and the consensus of views on additional details of operations that were appropriate.

Chairman PATMAN. And that makes it necessary for him to be present at the meetings of the Open Market Committee?

Mr. HAYES. Yes, sir.

Chairman PATMAN. In other words, this alone is not sufficient to him; he must be there, he must hear what is said, must know what the sense of the members of the Open Market Committee happens to be at the time in this discussion.

Mr. HAYES. Well, I think it is almost essential that he be there. In theory he could get most of the sense of the meeting from the minutes, which are very detailed, and go far beyond this directive.

Chairman PATMAN. You mean the minutes of the Open Market Committee?

Mr. HAYES. The minutes of the Open Market Committee meeting.

Chairman PATMAN. I assume these minutes are referred to each member of the Open Market Committee, as well as the presidents of the banks?

Mr. HAYES. That is right, sir.

Chairman PATMAN. And that is done immediately after the meeting?

Mr. HAYES. As soon as they are prepared.

Chairman PATMAN. And the manager of the account takes into consideration his own notes and his own knowledge, having been there at the time and considered the minutes of the meeting?

Mr. HAYES. I think he makes a few informal pencil notes in order to have a pretty good idea of what the meeting was about, until he sees the formal minutes. But invariably, as far as I know, the formal minutes of the meeting convey all that he has and more of detail and, therefore——

Chairman PATMAN. In other words, Mr. Hayes, you are saying that this, by itself, is not sufficient.

Mr. HAYES. That is correct.

Chairman PATMAN. It is not sufficient.

Mr. HAYES. He certainly could not operate on the basis of this directive alone.

Chairman PATMAN. It seems to me, Mr. Hayes, that this system of issuing directives or policy statements in such vague and indefinite language means that they cannot be interpreted without something beyond the language in which they are given, that is behind the screen, that they cannot see.

It occurs to me that that is not complying with the spirit of the law, which requires you to put in your annual report——

Mr. HAYES. Well, Mr. Patman, if I may just quote from this meeting that we are talking about, the March 1 meeting, there is discussion on pages 42 and 43 of various conditions that we were facing, and then there is a sentence in the middle of page 43 saying:

> In view of this short-run consideration, along with considerations relating to business and financial developments generally, the Committee concluded that it would be appropriate to supply reserves to the banking system somewhat more readily. Accordingly, the consensus favored, for the immediate future, a policy of moderately less restraint.

My feeling is, that gives him a much more exact guide of what he is to do, and that is in the policy record.

Chairman PATMAN. I assume, though, Mr. Hayes, this is not as full and complete as the minutes of the Open Market Committee as of that date?

Mr. HAYES. That is correct.

Chairman PATMAN. It is not nearly as full.

Mr. HAYES. No, sir.

Chairman PATMAN. How much would that normally be, on an average? Several pages?

Mr. HAYES. The minutes?

Chairman PATMAN. Yes, sir.

Mr. HAYES. I would think they would run to 40 or 50 pages, maybe even more, 60.

Chairman PATMAN. This is one or two?

Mr. HAYES. Yes, sir.

Chairman PATMAN. This is condensing it.

Mr. HAYES. Yes, sir.

Chairman PATMAN. I am impressed, Mr. Hayes, by the fact that you have a different language in the financial community, particularly in the Federal Reserve circles. That is really shown up in this testimony clearly, when you say that and when the testimony shows that certain people—the traders, the dealers, the sophisticated people—can very quickly understand what this means. When you begin to put it into effect, your first actions will indicate, and they will know. But the people, the public generally, will not know; is that a correct impression or not?

Mr. HAYES. I think it is generally incorrect, Mr. Patman.

Chairman PATMAN. Generally incorrect?

Mr. HAYES. Yes, sir.

Chairman PATMAN. Well, in his testimony yesterday, Mr. Rouse commended a book by Mr. Roosa very much; one which I have read with great interest, and Mr. Roosa, I thought, rather frankly admitted that the traders and dealers could understand better than the general public could understand, and Mr. Roosa put this in his book.

On page 104 I want to read a little part here:

> The student interested in knowing what policy is and prepared to analyze the complex of all daily and weekly published data can generally come fairly close to knowing in a short time.

I am skipping down one sentence:

> The characteristically detailed annual reviews of the record published for the Board of Governors and most Federal Reserve banks in monthly Federal Reserve Bulletins and the New York Reserve Bank's last Monthly Review, provide enough analyses of what was done, and why, soon enough after the events, to permit the specialist to acquire the body of knowledge which can equip him to make informed judgments of later data and developments. This does mean, however, that the interpretation of central bank action, and the evaluation of its influence, has become, like many other things in this modern day, a zone reserved largely for the specialists.

Here it looks to me like there is a plain admission that the general public is not expected to interpret these orders or these policy statements; but the specialist, who is really on his toes, with the information published regularly available to him, can have inside knowledge.

Mr. HAYES. Well, Mr. Patman, if I may answer in this way:

It seems to me it is a truism that a specialist looking at a given set of data, can get more out of it than a layman who has no background on the subject.

What I meant to say when I felt that your conclusion was generally incorrect was that there is no reason why anyone who cares to study the subject and takes enough interest to get the background and to understand the terms, there is no reason why any such person, whether he be a dealer in the market or a student in the university or anyone else, there is no reason why he cannot take those data that are available and get just as accurate a picture of what we are doing as somebody who is in the market.

Chairman PATMAN. I have no feeling gainst New York or the banking community or Wall Street or the Federal Reserve. But I do feel like it is hardly fair to the public generally to be left in the dark about all these things, and a language used and signs given that will alert and give knowledge and information to people in such a small area, and under the circumstances whereby they can profit from it, when the public cannot.

Senator BUSH. Would the chairman yield for a question?

Chairman PATMAN. I would be glad to; yes, sir.

Senator BUSH. What do you have in mind in this connection? I see nothing but inference. Would you say what you had in mind?

Chairman PATMAN. I made it very plain—I am sorry the Senator was not here——

Senator BUSH. I was late.

Chairman PATMAN. I tried to make it plain, but no plainer than Mr. Roosa made in his book, that they are speaking two languages, one language to the experts and specialists in Wall Street, and the other language which a fellow on Main Street would not understand.

Senator BUSH. What you are saying is that it is inappropriate for an industry to develop a lingo of its own. We have one up here on the Hill. We talk in terms which the average citizen does not understand.

Chairman PATMAN. But his interest is not harmed.

Senator BUSH. I do not know whether it is or not.

Chairman PATMAN. Not by individual statements.

Senator BUSH. I don't recall any statements here today and yesterday; I do not recall that the public interest has been harmed. If it has been harmed, I think it ought to be brought out. I do not think you are bringing out any incident where the public has been harmed.

Chairman PATMAN. That would be another matter. That would be a question of investigating the facts. But when you show that the people have these great advantages, these special privileges, it is up to you to assume whether or not any of them might use it to their benefit and to the detriment of the public.

Senator BUSH. But I insist so far in these hearings, so far as I have been able to tell, and all day yesterday that I was here, there has been no evidence of special privileges being accorded to special groups.

Chairman PATMAN. We are not going into that. That is not part of our investigation, but my time is up, and I yield to the Senator from Connecticut.

Senator BUSH. I will yield you back 5 minutes of my time, in my questioning, so that you can enlighten me.

Chairman PATMAN. Certainly I would be very glad to be questioned by the distinguished Senator from Connecticut.

Senator BUSH. As long as you bring up these points, and there seems to be lingering in your mind, my able friend, some suspicion of skulduggery, will you enlighten the committee as well as the witness as to what they are?

Chairman PATMAN. Well, you brought out the word yourself, and probably there is some reason for you to have that in your mind. You probably know a lot more about it than I do.

Senator BUSH. No.

Chairman PATMAN. You are a Street man and know the score.

Senator BUSH. You have been investigating the Federal Reserve Board so long that the "memory of man runneth not to the contrary." [Laughter.]

Chairman PATMAN. All I want is information that is disclosed by our monetary authorities, by people who have more control over the economy of this Nation than the Congress of the United States, that the information that is put out should be in language, not gobbledy-

gook, but language that all people can understand, not just a few who are in a position to profit from it. Maybe they do not profit from it; I am not saying they do. But I do think they have an opportunity there that the public generally does not have.

Senator BUSH. You have fractioned this Committee into so many subcommittees that it is hard to keep up with them. I suggest, as long as we have so many, that there be one more, which should be the Subcommittee on Languages, so that we may go into the parlance of the Federal Reserve bank and see what we can find out, what is deceptive.

Chairman PATMAN. We have already found it out. It is right here.

Senator BUSH. No. You just think it is true. But there has been no evidence adduced before this Committee that the public interest has been harmed by anything that you have read or heard said by these expert public servants.

Chairman PATMAN. Well, of course, that would require a specific investigation for that purpose, and that is not before us.

Senator BUSH. You brought it up; I did not bring it up. I think you ought to explain what it is that is in the back of your mind.

Chairman PATMAN. I think it is possible for skulduggery to exist. I think it is asking a lot of people not to take advantage of opportunities under our private enterprise system that are given to them that are perfectly legal and all right; they are not violating any law.

Senator BUSH. Have you any evidence of things that have happened in the last year? We are considering the report of 1960. Have you any evidence of things that have happened that would suggest to you that there has been any skulduggery?

Chairman PATMAN. That is not within our province. We are not investigating that. We are going into this annual report to see whether or not the public interest is properly protected and to see if the public is informed correctly.

Senator BUSH. I perfectly agree with you that it is not within our province, but you brought it into this hearing, and that is the reason why I am trying to find out what you have in mind.

Chairman PATMAN. No, I just brought in here something that is quite proper, I think; namely, to find out what our servants and agents, the Open Market Committee—they do not always act as our servants and agents, from my viewpoint—are doing. I am not questioning their motives or honesty, but I am trying to bring out that as our agents they are following a policy and a practice that results in a few people having particular knowledge upon which they can capitalize and make gains that are not presented to the public generally in a way that they can profit in a similar manner.

In other words, we are using not precisely sign language, but a language that specialists can understand, and know what the score is while the public generally will not know what the score is. That is the point I am trying to bring out, Senator Bush.

Senator BUSH. Well, I think your motive, if that is it, is a perfectly sound one. But I do not think you have brought out anything here from any of the witnesses so far that would suggest that your suspicions are well founded.

But I would be glad to——

Chairman PATMAN. Right in here.

Senator BUSH. I do not see anything. That gentleman whose book you read is the Under Secretary of the Treasury under your President's administration, and a very able man. Everybody applauded his nomination.

Chairman PATMAN. A very able man, but he shows what I am saying is correct.

Senator BUSH. No.

Chairman PATMAN. That there are two languages: one for the fellow who can profit from it, the other for the public generally. It is not intended to be misleading to the public, I do not charge them with intending to, but the end result is that the public does not know, and to that extent they do not have the knowledge that the insiders have.

Senator BUSH. Your inference, then, is that the people in these responsible positions in the Federal Reserve System are so dull that they do not really see that they are injuring the public interest; is that right?

Chairman PATMAN. No; I do not say that at all. They are smart people.

Senator BUSH. Well, I thank you for your indulgence, and I will yield the balance of my time.

Chairman PATMAN. Senator Proximire.

Senator PROXMIRE. I pass.

Chairman PATMAN. Senator Pell.

Senator PELL. Mr. Hayes, would it not be true that the same factors which the Open Market Committee uses to reach a conclusion or a recommendation or a directive would be the same as those which would also guide the dealers in securities—presuming that they are informed and sophisticated people? The same general information would be available to them and, hence, they could also arrive at the same conclusions. The insiders that we are talking about, that we talked about earlier, would be pretty well informed and hence have a pretty sound idea as to what your committee was going to do before they did it themselves.

Mr. HAYES Well, I would like to bring out this distinction, Senator. When we reach a decision in the Open Market Committee, it is a decision largely in terms of the degree of pressure you are going to try to maintain in the credit and money markets. It never is a decision that we are going to buy thus and so, or we are going to sell thus and so, because we do not know when we reach the decision whether we are going to have to buy or sell.

Senator PELL. But the factors that lead you to that decision are open and known to the general public, are they not?

Mr. HAYES. I would not say that all the factors are as well known to the general public as they are to us, because we have an unusually able fact-gathering organization putting all the relevant statistics, credit and business statistics, before the Committee, and the Committee also has the experience of the manager who has been on the trading desk the preceding 3 weeks, and can give all the details of how the market is reacting to all the various economic developments.

So I would say we are in a favored position so far as facts go.

But what I was trying to bring out was, when we reach a decision, I think there may be some misconception, possibly, among some members of the public, as to what kind of a decision we reach. We do

not reach a decision that we are going to go out and buy such and such an issue. We reach a decision that we are going to try to maintain a certain degree of pressure, a certain general atmosphere of restraint or ease, more or less the same, and with certain special considerations, perhaps, for certain rates, and things of that kind.

So that we have not reached a decision in terms of actual purchases or sales.

Senator PELL. But my question, or my thought, is, would it not be possible for the informed dealer to arrive at just about the same conclusion that your Committee does, at the same time, without any need for inside information?

Mr. HAYES. Well, I would say this: That the informed dealer, as any informed student of the subject, including many nondealers, people in the universities or in any other walks of life, have such an abundance of good statistics coming out, many of which we have put out, including this Monthly Review I was speaking about, and the weekly statistics which are announced in great detail every Thursday afternoon, with all these facts at hand, for instance, showing what kind of free reserves we have been maintaining, and what kind of transactions we have made during the preceding week, I would maintain that any good student of the subject would probably come to a pretty good conclusion as to the general kind of policy we were following, and it would not be confined to the dealers.

Almost anybody could do it.

Senator PELL. Have you any idea as to what percentage of your officers, your officials, move into private industry each year?

Mr. HAYES. Well, I always knock on wood on this, but it is not a very high percentage, fortunately. We have lost——

Senator PELL. Five percent, 10 percent?

Mr. HAYES. Of our officers, no. I would think it is less than that. I think we have lost—I can think of two or three officers in the last couple of years.

Senator PELL. So there would be relatively few people on the street who had had experience in Federal Reserve matters?

Mr. HAYES. Well, you are talking now of officers?

Senator PELL. Officials.

Mr. HAYES. We have lost other younger men who have been with us, who have gone into firms on the street, but many have gone into universities, both officers and employees.

Senator PELL. One final question: I notice that in one of your reports you say you take more into account the tone of the market than actual statistics. I was wondering if you could enlarge on that thought?

Mr. HAYES. Well, the tone of the market is a very difficult thing to describe unless you are actually sitting at this trading desk, which is sort of the nerve center of the bank and the nerve center of the System for keeping in touch with credit and banking and money market developments.

But I would say that it is a compound of all kinds of impressions you get from the volume of trading, the speed of trading, what is happening to prices, what the bank's position is, whether the dealers are hard up for financing or have plenty of financing, whether funds are well distributed throughout the country or not well distributed.

It is such a compound of a great many things to which we refer rather briefly and not particularly usefully as the tone of the market, but we do not have a better term.

Senator PELL. Thank you, sir.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Thank you, Mr. Chairman.

I want to congratulate you, Mr. Hayes, on a very able and helpful statement.

Mr. HAYES. Thank you, sir.

Representative REUSS. You persuade me here, or come close to persuading me on your two points about the length of a given monetary policy, and also the unwisdom of contemporaneous announcement of what lines you are taking.

I note that you say that the Open Market Committee has not yet considered the matter of whether quarterly publications with a suitable timelag might not be in the public interest, and I would ask you, as Vice Chairman of the Committee, if you would ask your colleagues to consider this at a proper meeting. I think it should be given consideration.

Mr. HAYES. Well, I would be glad to pass that wish along. I would suggest that you express that wish also to the Chairman, who is more of a spokesman for the Committee than I am.

Representative REUSS. We will; but in case he was not there at the next meeting, and you were presiding, you would have it in your mind, too.

Mr. HAYES. Yes, I would be glad to do that; yes, sir.

Representative REUSS. I would like you to direct your attention to the meeting of the Open Market Committee of March 1, 1960, as reported on page 47 and following of the report. There was presented to you the policy directives which have been in existence basically since 1953. They are set forth on pages 47 and 48, and they boil down to the following, as I read them:

(*a*) The Open Market Committee is supposed to concern itself just with monetary and credit policy and not with such other matters as debt management.

(*b*) You are supposed to deal only in, it was usually said, bills—I guess the word of art here is short-term securities.

(*c*) You are not supposed to swap securities so that you change the maturity pattern.

Is that a fair rough paraphrase of what those three commands require?

Mr. HAYES. I think so; yes, sir.

Representative REUSS. When the time came for a vote on this, you and Mr. Bopp, according to the record, voted no; is that correct?

Mr. HAYES. That is correct.

Representative REUSS. I would like to explore some of the factors behind that.

Am I right in inferring that you believe that while monetary and credit policy should be the major object of the Open Market Committee activity, nevertheless where these objectives can be fully served, it is entirely in order also to consider the impact of what you do on debt management?

Mr. HAYES. Well, I would not object to the first policy, that it is not our policy to support any pattern of prices and yields in the Government securities market. In fact, I am enthusiastically in support of that.

Representative REUSS. I would not object either, let me add. I directed your attention to the second part of point "a" which says that the Open Market Committee is in business solely to concern itself with monetary and credit policy. By implication, therefore, it is not to concern itself with that other branch of policy called debt management.

Mr. HAYES. I would not object to that statement either, because I would interpret monetary and credit policy as being a very broad subject that almost includes——

Representative REUSS. Including debt management?

Mr. HAYES. There are certain debt-management aspects to it, but we recognize debt management is not our primary responsibility, and that certainly the Treasury has the major responsibility there. I would think we would always have to pay some attention to debt management in our decisions, but——

Representative REUSS. Where you can help debt management entirely consistently with your major mission of that portion of monetary policy whose impact is other than on debt management, you believe, as I believe, do you not, that it is perfectly proper to do what you can for debt management?

Mr. HAYES. I think that is true. But I think that would be the general feeling of the Committee, too. I do not think I differ from them on that point. I think the main differences, if I may say so——

Representative REUSS. Yes.

Mr. HAYES (continuing). Have to do with the other points as to the confining of operations to short-term securities, and also the statement that transactions shall be entered into solely for the purpose of providing or absorbing reserves.

You deal with that second one first; I think that is, perhaps, an unnecessarily rigid statement of what the purposes—that we obviously do pay attention to interest rates, for one thing.

In practice, I think, that would not be denied, perhaps, by any other members of the committee, but it is a matter of the statement of the difference in the way the philosophy should be stated which made me vote against it.

Representative REUSS. We are now looking at paragraph "c."

Mr. HAYES. "C"; yes, sir.

Representative REUSS. Let me direct your attention to the second part of that paragraph, the words, "and shall not include offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolios."

Let me present to you a series of ideas in that connection to get your view on them. As I see the situation, and I would like your comment on this, in recent years the market for Government long-term securities has shown a disturbing shortage on the demand side. There have not been enough people eagerly bidding for Government bonds.

As a result, the price has gone down, and this has produced many disturbing effects, including, among others, the fact that our national debt composition, far from being lengthened—which seems to many of us a desirable object of debt-management policy—has actually been shortened in recent years.

I call your attention also to the general policy of recent months in the Open Market Committee of trying to nudge, I guess the word is, long-term interest rates down while not pressing down short-term interest rates, perhaps even increasing them slightly so as to cut down on the transfer of short-term funds in this country to investments abroad, with their attendant gold outflow.

I call your attention also to the latest figures on the composition of the national debt which shows that of a holding by the Federal Reserve System of around $27 billion of U.S. securities, only $2 billion—I am rounding this off a bit, only $2 billion—are bonds of 5 years or more; all the rest are bills, notes, and certificates.

I now ask you whether it would not be possible and desirable, without in any way supporting a particular interest yield or a particular price level for longer term Government securities, for the Federal Reserve to change the composition of its portfolio over a period of time so that it would own a larger proportion of bonds than the very negligible percentage that it now owns and, conversely, a somewhat smaller percentage of short-term obligations?

I ask you whether that would not be a good thing for the country in terms of our balance-of-payments situation, in terms of the desirable goal of lengthening the national debt, and in terms of making it possible for the Treasury to at least contemplate the issuance of longer term securities from time to time?

One more qualification before I ask you to comment. This process, if embarked upon, would have to be embarked upon according to the same general philosophical rules that you have set down in your paper, that is to say, you do not announce any set policy; neither do you necessarily saddle yourself with any set policy for any set period of time; but as opportunities appear, you do make these concessions, which means that you would have to amend the paragraph "c." that we are talking about which, as I read it, forbids such swapping of securities.

Would you comment on that?

Mr. Hayes. Mr. Reuss, that is a long question, and if I may, I will make a long answer.

I would like to make clear that my differences with some of the members of the committee, as brought out, for instance, in this vote, are differences of degree only, and to a very large extent we are in full agreement.

I would say on 99 percent of our business we are in full agreement. I am in full agreement that short-term securities, generally speaking, are the best means for performing our major function which is, and I should have brought this out in my previous answer, which is, primarily for the purpose of absorbing or adding reserves. That is the main objective of our activity.

I think that that being the case, it would be generally desirable to have a portfolio with considerable emphasis on the short-term end because that is our best stock in trade.

If, anything, I would say that maybe we have not had enough short-term securities in our portfolio. So that from the standpoint of portfolio composition, I would not see any—I would not consider it as a desirable goal to try to deliberately lengthen the average maturity of the portfolio. Quite the contrary, I think we might welcome a move in the other direction.

Now, that does not mean that I do not see opportunities under certain circumstances, such as we have had this year, to do some purchasing in the area outside of the short-term field, and during such periods, obviously, you will be having a tendency to add to the other-than-short-term portion of your portfolio. I do not see any—I think that can be useful, and I would have no objection to it.

Going back to this statement of the offsetting purchases and sales of securities for the purposes of altering the maturity pattern of the portfolio, to my mind that is a slightly fuzzy and, perhaps, misleading way of stating what we really are dealing with here.

In the language of the street what we are talking about there are swaps, and swaps, the purchase of some maturities and the sales of other maturities, are usually undertaken for some reason other than the purpose of altering the maturity pattern of the portfolio.

For instance, this year we have done some swapping where the purpose was to relieve pressure on the short rate, at the same time not put undue pressure on the reserve position of the banks generally; that is my answer.

Representative REUSS. I appreciate your answer very much. My time has run out. I will be back.

Chairman PATMAN. Mrs. Griffiths.

Representative GRIFFITHS. Thank you very much, Mr. Chairman. I would like to ask you, Does a policy change always result in the same response in the market? Does the same policy change result in the same response?

Mr. HAYES. I would think it was highly improbable that it would ever result in the same response, Mrs. Griffiths.

Representative GRIFFITHS. Do you analyze the factors of the difference?

Mr. HAYES. We try our best.

Representative GRIFFITHS. As to what you think contributed to the difference?

Mr. HAYES. Mrs. Griffiths, we do.

Representative GRIFFITHS. Do you reduce this analysis to writing?

Mr. HAYES. Yes, we make very, very full reports of our estimate of how the market is reacting to various actions of our own and other influences affecting it, and we have—I think Mr. Rouse brought out that he reports daily, weekly, and also after the occasion of each open market meeting, in great detail to other members of the Committee and other Presidents.

Representative GRIFFITHS. I did not understand, was that in writing?

Mr. HAYES. Yes, those are written reports.

Representative GRIFFITHS. Written reports.

Are those available to this committee or to the public?

Mr. HAYES. No, those are not generally available. Those are among the confidential records of the Committee.

Representative GRIFFITHS. Would there be any reason why, after the passage of years, that we could not be given those, that they could not be made available?

Mr. HAYES. Well, my own feeling on that is that the extent of our disclosure of records has been traditionally, for many years, rather limited.

I have always understood that was in accordance with the Congress wishes. Obviously we are a creature of Congress, and if it were felt that we should change that practice it could be changed.

It would be a decision that, I should think, the Open Market Committee, as a whole, would have to take up on the basis of some formal request, and I would suggest that is more appropriately submitted to the Chairman than to me.

Representative GRIFFITHS. In your statement you point out that an announced shift in System policy might set off a wave of optimism or pessimism which, in turn, might result in substantial changes in security prices and yields.

Do you think that it would continue after many announced policy shifts to have such violent reaction?

Mr. HAYES. I think that the reaction, Mrs. Griffiths, in the market is a highly unpredictable factor, and I do not know whether it would or would not.

I would be afraid that it might well have such effects even though you might run along for several periods and make an announcement that would not have these exaggerated effects, and then, despite the fact that the public was used to the announcement, under certain conditions they might still take an announcement and exaggerate its effect, and it might have these undesirable effects on the market.

Representative GRIFFITHS. Wouldn't the real harm fall upon the speculators?

Mr. HAYES. I beg your pardon?

Representative GRIFFITHS. Only those who were investing speculatively, wouldn't they be the people most injured?

Mr. HAYES. Well, I would think that unnecessarily violent swings in the market in either direction are harmful to all of our investors and to borrowers, too.

Representative GRIFFITHS. I would like to ask you a question here which the staff seems to want to know an answer to, and I think it is interesting, too:

Reference is made on several occasions to—

> relating the supply of money in the market to the needs of commerce and business.

What significance has this statement in a policy directive unless related to some equilibrium level of interest rates?

Mr. HAYES. Would you rephrase that question, Mrs. Griffiths?

Representative GRIFFITHS. Well or——

Mr. HAYES. Or could you repeat the question, I am sorry.

Representative GRIFFITHS. I would be glad to rephrase it or repeat it.

Reference is made on several occasions to—

> relating the supply of money in the market to the needs of commerce and business.

What significance has this statement in a policy directive unless related to some equilibrium level of interest rates?

Mr. HAYES. Oh, I see.

I would say that by equilibrium level of interest rates, I assume the reference is made ot the whole question of the relationship between savings and investments, demands for credit, and sources of credit, and clearly that kind of an analysis plays a very large part in our decisions at any given moment as to our interpretation at any given moment of the actual amount of the money supply.

We have to give consideration both to the money supply proper and to the status of credit markets, in general which, of course, have a very direct bearing on this equilibrium level of interest rates.

Representative GRIFFITHS. So that the policy shifts have a direct bearing on interest rates, is that right?

Mr. HAYES. Well, policy shifts affect interest rates, but are by no means, normally speaking, the major factor.

The basic elements of supply and demand from savers and investors are, by far, the more important elements in the market, and our activities and policy usually are much less, have much less bearing, on that level of interest rates, particularly the long-term rate.

Representative GRIFFITHS. Thank you very much. Thank you, Mr. Chairman.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Mr. Hayes, I want to follow up some of the points that were raised and emphasized by Congressman Reuss.

I though that Congressman Reuss gave some very persuasive reasons for greater emphasis on long-term securities in the open market operations, and I could add a few more.

It seems to me, in view of the benefits to the taxpayer of the Fed's portfolio having the biggest possible yield, and the general tendency for long-term securities to yield more as a little better investment, your justification of this position you take was strictly kind of a technical justification that did not satisfy me, because I am so ill acquainted with the technical aspects that you have to confront. But your explanation was simply this was a more useful way of adjusting reserves.

Mr. HAYES. Yes, sir.

Senator PROXMIRE. In view of the great benefits to the taxpayer and to the economy and the balance-of-payments situation, it would seem to me that this had better be a pretty persuasive and overwhelming reason if it is the only one, for not getting a better balance.

Mr. HAYES. Well, Senator, I share your concern for the taxpayer and the overall economy. But what I tried to bring out was that, by the very nature of the markets, their size and flexibility and practicability, when we have occasion to draw, to put in the market or draw out of the market large amounts of reserves, it is frequently—it would simply be impossible to handle that kind of volume in the intermediate or longer end, whereas the short end is accustomed to handling tremendous totals in a short time, and I think that is probably inherent in our structure, that we will always have to rely mainly on the short-term securities.

Senator PROXMIRE. Can you be a little more specific. Why would it be so bad? Let me expand this by saying that supposing you take

the position of somebody like Dr. Friedman or Senator Douglas, which is that we should regularly expand the money supply, say, 3 percent per year; if you take that view or take the view that this will be done, but not at any regular rate, can't you continue to have a very large amount of short-term securities, but also buy quite heavily in the long-term market?

Mr. HAYES. Well, let me bring this difference out, that there is a great difference between the net amount of our addition to our portfolio in a given year, let us say, and the gross transactions in and out.

We are constantly faced with the needs for putting in reserves or withdrawing them in very large quantities merely to offset what we call the market factors, things like the amount of currency in circulation or the size of the Treasury balance or the inflow or outflow of gold, which require us to engage in large transactions merely to keep the same degree of general restraint.

Senator PROXMIRE. These are plus or minus transactions, are they not?

Mr. HAYES. Yes, sir; and those require—those account for the biggest volume of our transactions, and I would still feel that it would be very difficult, over any extended period of time, to do a large proportion of that business in longer maturities.

Senator PROXMIRE. I understand that, and I think it is an excellent point.

But over the years the portfolio has expanded as the result of open market operations, concentrated overwhelmingly in very short terms. Why couldn't an increasingly larger share of the portfolio be invested for the long pull in long-term securities? The transactions on a day-to-day basis could then be concentrated in the bills area?

Mr. HAYES. Well, I would like to bring this other distinction out, too; whereas short-term securities fluctuate in price very little because of the maturity and the rendering of a yield which means very little change in price, so the chances of any loss or profit are very small; whereas the longer the maturity, the greater the swings in price for yield changes.

Therefore, the longer term area is one in which operations of a given amount per se tend to bring about much wider price swings than in the short end, and, by and large, wide price swings tend to be disruptive elements.

If I can mention one other consideration, I do not think we should try to operate an open market account primarily from the standpoint of the considerations of the national debt.

I think we obviously have to have those in the back of our head, too, but I think the important thing is to decide whether operations in the short end or the intermediate end or the long end under the particular circumstances are most likely to accomplish what you want to accomplish in the general atmosphere of the money market and the credit market, because that is our big responsibility.

Senator PROXMIRE. That is the big responsibility.

But also, as you say, the Federal Reserve Board is an instrument of the Congress and the people of the United States. It is not an instrument of the money market.

Mr. HAYES. That is correct.

Senator PROXMIRE. And if the overall effect on the economy, on an economy in which we underutilize our resources, where we have heavy unemployment, and a great idle factory capacity, if under these circumstances the economy can benefit from a long-range policy of an expanding monetary supply, then it would seem that the argument can be made that, No. 1, you can build a bigger portfolio in order to expand the money supply by buying more Federal securities; and, No. 2, that, as you build this on a long-term steady basis, that you can regularly and steadily buy long-term securities, but leave for the adjustment of the currency supply and other immediate and short-term problems the transactions in the bills-only area.

Mr. HAYES. Well, of course, it is never a very steady process, this putting in of the reserves to provide for the long-term growth. Long-term growth occurs as the net resultant of wide swings.

Senator PROXMIRE. I understand.

Mr. HAYES. And you might go for a long time without putting anything in, and then you might be doing a great deal——

Senator PROXMIRE. That is why it seems to me an answer might be that the policy, in general, should be that you buy but rarely sell long-terms, but that you buy and sell short-terms.

Mr. HAYES. Well, I think that there is a tendency in that direction; I would agree. That since the money supply is growing and, by and large, reserve needs are growing, there is a tendency for our portfolio to grow, and we do not necessarily have to sell everything that we buy.

I quite agree with that.

But I would still go back to my contention that if there is a need for decision whether or not, or whether to choose shorts or longs or intermediates at any given time, should be made solely on the basis of the facts, what they will be with respect to your near-term monetary objectives.

I would certainly have no objection if it came out that you happened to accumulate some more long-term securities, subject to the provision which I, the proviso that I, brought out earlier, that we must always have at hand a good sizable supply of short-term securities, because that is our bread and butter that we need day in and day out.

Senator PROXMIRE. It seems to me that while I can see the wisdom in not announcing policies in advance, at the same time there might be some communication between the Open Market Committee and the Federal Reserve Board and the Congress on the notion of whether or not it was wise to use open market operations as the primary means, or one of the—I guess the primary means of expanding the money supply.

How do you feel about this, as distinguished from the affecting the legal reserves?

Mr. HAYES. As reserve requirements?

Senator PROXMIRE. Yes.

Mr. HAYES. Well, I think that they both have very useful places under varying conditions.

I think that if, for some reason, we should feel that at a given time it would be very desirable to get a broad distribution of additional reserves throughout the banking system, that then a liberalization of

reserve requirements might prove more timely and useful than open market operations.

But, by and large, as you know, we use open market operations a great deal of the time, and we think they are a highly useful weapon, too.

I think they both have their place, and I would doubt whether the effort to confine your addition of reserves to open market operations would have any great effect, beneficial effect, on the national debt management.

It raises some questions, some questions as to total liquidity in the economy over a period. I think that there are pros and cons and, as I say, I think the decision should be reached more on the basis of what you want the effect of the particular operation to be at the particular time.

There is room for both of these instruments.

Senator PROXMIRE. My time is up. I will come back to that. Thank you, sir.

Chairman PATMAN. Mr. Hayes, I want to ask you one or two questions.

Suppose you had issued and made public that policy statement of the Board of March 1, 1960, that I read to you a while ago; how could that have had any harmful effect?

Now, remember, the Federal Reserve Board makes public immediately very important statements and decisions, including policy decisions, of course, like the change in reserve requirements.

It is true they time policy statements after the market closes, during the week. Lowering or raising reserve requirements for banks and other important actions like that made by the Federal Reserve Board are announced immediately.

Why is it not in the public interest to issue your statements the same way—immediately, quickly, just like the Federal Reserve Board?

Mr. HAYES. Well, Mr. Patman, naturally, by their very nature, you have to announce a change in reserve requirements. It could not be effective if it were not announced. And the discount rate the same way. Those are just inherently public actions.

I think there are advantages in being able to operate in the open market area, and to get the effects from the actions themselves, rather than from some kind of verbal accompaniment of the actions.

I would like to mention, if I may, a list of reasons for nondisclosure of unpublished information of the Committee that is in the rules on organization and information, Rules on Procedure of the Federal Open Market Committee.

Might I read a paragraph?

Chairman PATMAN. Do you have a copy of those rules?

Mr. HAYES. Yes, sir.

Chairman PATMAN. That we may have?

Mr. HAYES. Yes, sir.

Chairman PATMAN. Will you let us have one, please—not your copy, but an extra copy?

Mr. HAYES. Yes. I can get you one.

Chairman PATMAN. That will be all right.

We would just like to have it for our record, not to put it into the record.

Mr. HAYES. May I read it?

Chairman PATMAN. Yes, sir; you may proceed.

Mr. HAYES. Yes.

These are the reasons for nondisclosure:

The nondisclosure of unpublished information of the Committee is generally required in the public interest for one or more of the following reasons:

(1) Disclosure of unpublished information concerning policies with respect to future open market operations which are under consideration or have been adopted by the Committee, and of unpublished information which might aid in anticipating action by the Committee would—

(1) interfere with the accomplishment of the objectives of the Committee's actions taken with a view to accommodating commerce and business, and with regard to their bearing upon the general credit situation of the country;

(2) permit speculators and others to reap unfair profits or other unfair advantages by speculative trading in securities and otherwise;

(3) interfere with the orderly execution of policies adopted by the Committee;

(4) result in unnecessary and unwarranted disturbances in the securities markets;

(5) make open market operations more costly to the Federal Reserve banks;

(6) interfere with the orderly execution and accomplishment of the objectives of policies adopted by other Government agencies concerned with the economic and fiscal matters; and

(7) cause misinterpretations and misunderstandings, with possible resultant impairment of public confidence in the Nation's financial structure.

I would like to mention this, too: That the idea of Open Market operations being an instrument which is applied in the market with a minimum of fanfare, and with letting the actions speak for themselves, is not a unique idea of the U.S. central banking system; it is a pretty well accepted central banking technique in many advanced countries in the world.

Chairman PATMAN. Mr. Hayes, rather than ask you some questions that have been prepared here by the staff at the direction of the committee to bring out certain points, we would like to have brought out, at least, the answers to these questions, and may I give you the questions and ask you to answer them for the record when you correct the transcript or examine your remarks?

Mr. HAYES. Yes, sir.

(Federal Reserve System answers to these questions appear in Chairman Martin's testimony. See p. 147.)

Chairman PATMAN. I want to go back to the annual report again. At page 119 there is the statement that the Reserve banks have a surplus of $817,420,900. What reason can you give as to why that money should not be paid into the Treasury of the United States and save the taxpayer that much interest on that large amount of money? In other words, what good does that surplus do with the Federal Reserve bank? Why do you have it? Why do you keep it? Why shouldn't it be turned over to the Treasury?

Mr. HAYES. Mr. Patman, as I recall, we had quite a conversation on this about a year ago.

Chairman PATMAN. Yes, sir.

Mr. HAYES. To put it briefly, I would say that the Congress, in its wisdom, set up the Federal Reserve System with a system of banks having capital and surplus. It was set up in corporate form and, of course, having capital—I should have said they set them up with

capital, and surplus has accumulated through their operations, but they were set up in corporate form.

It seems to me they have performed, on the whole, a very useful service in that form.

I believe that the fact that they are run as quasi-Government organizations in the public interest, but with this aspect of corporate structure, and with some of the characteristics of a private organization has, by and large, been official, and a tradition has been built up that capital and surplus—I should say there is a tradition in this country that capital and surplus are part of the stock in trade of a corporate organization; that unless you have a certain amount of surplus your capital may be easily impaired by unfortunate or unwise actions, and it gives a feeling of solidity and comfort to have some surplus there.

I think that it is desirable that we maintain this tradition, and that just as any corporation ought to have some surplus, I believe we should, too.

As you know, we felt recently, within the last year or two that, perhaps, the surplus was larger than it had to be, and I believe we voluntarily made a payment to the Treasury.

Chairman PATMAN. Yes, sir; you paid over $963,377,684 into the Treasury last year, nearly $1 billion.

Mr. HAYES. Right, sir; yes, sir.

Chairman PATMAN. I know you have been paying it in, and I know what you say there is true, that there is a tradition which has been built up. But this is kind of a make-believe deal, the way I see it. It is a pseudo—it is not meaningful. You do not need this surplus, you do not use it. You could not use this surplus at all. You create your money when you buy bonds and things like that. You do not need a surplus.

Mr. HAYES. Mr. Patman, if we incurred losses through—which I hope we will not do, and I hope we will be prudent enough to avoid—but if we, as a result of large open market operations, let us say, in the longer end, if we were doing more in the longer end where price swings are much wider, and where the risk would be greater, it is conceivable that we might take losses.

Chairman PATMAN. But you do not have to sell at a loss; you can keep them. There is no time now—you are not like a bank, you know, I mean, an ordinary commercial bank. You do not have to sell anything and you can buy everything you want. You can buy the whole national debt if you wanted to.

Mr. HAYES. Well, Mr. Patman, to perform our primary function, as I was explaining to the Senator on your right, we do have to be in and out a great deal.

Chairman PATMAN. But there are no restrictions on your right to create all the money you want. You do not need this surplus, and that is costing the taxpayers a lot of money.

Mr. HAYES. Well, if we incur a loss we have to debit an account, and the only account we can debit would be our surplus.

Chairman PATMAN. Well, you do not have to take a loss, you see, you just do not have to sell.

Mr. HAYES. I would hope, as I say, we would not take losses, but it is conceivable we might.

Chairman PATMAN. Yes, sir. I will yield to Senator Pell, I believe, who is next.

Senator PELL. Thank you, Mr. Chairman.

In view of the present runaway market that exists today—I realize you are not a member of the Board of Governors—but as president of the New York Federal Reserve Bank, I wondered why thought had not been given to raising the margin requirements.

Mr. HAYES. Well, I believe, Senator, that the accepted custom is to avoid discussions in a meeting of this kind as to current or future policy. I do not think we can.

Senator PELL. I think you are right.

I have no further questions, Mr. Chairman.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Let me pursue further the matter of the composition of the Federal Reserve portfolio, and that we should have some figures put before us, I am taking the portfolio composition figures from the Federal Reserve, May 24, 1961, statement, and I am going to round them off a bit, but if you do not like the way I am rounding them, I will give them in detail.

Mr. Clerk, would you put 1 to 90 days. On the other side put $7, the figure 7.

On the next line put 90 to 1 year, and put $7.

Then another line called 1 to 5 years, and put $10.

Then another line 5 to 10 years, and put $2; and then put a line right under there and put $26.

This all very, very rough, but, by and large, it tells the story, I think, of the Federal Reserve portfolio which is that in the 1-to-90-day category you have got about $7 billion worth.

In the 90-day to 1-year category you have got about $7 million worth. In the 1 to 5 years you have got $10 billion worth; in the 5 to 10 years you have got $2 billion worth; over 10 years, negligible, for a total of $26 to $27 billion. That is about it; is it not?

Mr. HAYNES. I think that is right, sir; yes.

Representative REUSS. Now, let us examine the two points you made. You said, Mr. Hayes, that you needed, in order to conduct your open market operations, a lot of short-term securities. I can readily see that. The reason you need a lot of short-term securities is they pass in and out of the market with the least amount of discombobulation, since they are almost the equivalent of money, therefore, it is the easiest thing to deal in; isn't that correct?

Mr. HAYES. Correct, Mr. Reuss.

Representative REUSS. That was the rationale——

Mr. HAYES. Right.

Representative REUSS. That was the rationale of your statement.

Mr. HAYES. Right.

Representative REUSS. When you talk about that kind of a short-term security, the equivalent of money, you are talking about, are you not, a 90 day and less?

Mr. HAYES. I am thinking primarily of bills.

Representative REUSS. Primarily bills, which are 90 days and less.

Mr. HAYES. Some of them are and some of them run longer than that.

Representative REUSS. How long does——

Mr. HAYES. Bills now run up to 12 months, but the longer bills are a relatively small amount outstanding. The bulk of the bills are either 3 or 6 months.

Representative REUSS. Fine. So that we——

Mr. HAYES. These maturities include large issues of, perhaps, originally longer maturities coming due which would not, perhaps, be as easy to handle as bills under certain circumstances.

Representative REUSS. But I think our minds are together on what you would like to have in the cigarbox in order to conduct your business.

What amounts of bills, or very short-term pieces of paper, would you ideally like to have in the cigarbox in order to conduct the open market operations suitable for the decade of the sixties?

Mr. HAYES. Well, Mr. Reuss——

Representative REUSS. What is a good figure?

Mr. HAYES. I do not have an ideal portfolio in mind. I think this is reasonably satisfactory. I would not object to modifications in the direction of a few more longs. It would not do any harm, provided we had plenty of bills. I do not know offhand how many of those shorts are bills.

Representative REUSS. What I am getting at is: Are you not a little heavy around the middle, I mean your portfolio?

Mr. HAYES. Thank you, sir. [Laughter.]

Representative REUSS. You have got an awful lot of 1 to 5 years there, that are neither useful for open market operations of the type you have described, nor do they do very much at removing the anguish of the Treasury in having to go to market to issue new Treasury securities.

So what I put to you, sir, is this: Wouldn't the Republic be well served if the Open Market Committee tomorrow (1) repealed the rule, that I regard as quite a silly rule, that you cannot swap maturities, and then moved slowly but steadily toward a portfolio composition which (*a*) gave you as much in the short drawer as you would like, and if $7 billion is not enough, then as much more as you need, and (*b*) equally important, moved us out toward the long end a bit, and instead of having a really negligible $2 billion of 5 years and over in the portfolio, have somewhat more; and (2) achieved this result (*a*) by swaps within the portfolio and (*b*) by new purchases at such times as it is consistent with good monetary policy to increase the money supply? Why, in short, wouldn't it be an excellent idea to have all 12 of the members of the Open Market Committee vote as you did on March 1, 1960, vote, "No, we ought to change this silly old rule, and not place such a restrictive and doctrinaire requirement upon us"?

Mr. HAYES. Well, I would be delighted if they all voted the way I did, but I do not think that I would carry that necessarily to taking an action along the line you have proposed as to portfolio.

I would not see any harm in developments along the lines that you have outlined from the standpoint of portfolio composition as such; in fact, I can see that it might make reasonably good sense since the long end is pretty thin there, to have some more, I certainly would not object to it.

What I would pay most attention to though is how you got it there, and whether, in so doing, you were having effects in the market that you did not want to have.

Now, your operations in the longer ends are always rather delicate operations, I think, for various reasons, more delicate than operations in the shorter end, and it might not turn out that you wanted to do anything in the long end for a period of time.

Representative REUSS. I completely agree with you, sir, that long-term, 10-year bonds, 15-year bonds are not as apt an instrument for in-and-out trading as 90-day bills. But I am not suggesting that they be so used.

I am suggesting that since a considerable portion of your $27 billion portfolio, and it is going to get bigger, can lie dormant, is not necessary for the cigar box activity of day-to-day open market trading, why not do the Treasury and the taxpayers some good by nudging its portfolio toward a somewhat larger long-term holding.

I take it you have already said that this, if properly done, would make sense.

Mr. HAYES. If it fitted in with our week-to-week and month-to-month objectives of what we were doing currently, I would see no objection to it at all. But I would not like to put it as an objective that we really—I would not put it on the same level with respect to importance of objective as our regular monetary operations.

May I bring out one other factor, Mr. Reuss?

Representative REUSS. Surely.

Mr. HAYES. That we are operating generally within a market involving bank reserves, and I think it is inherently rather appropriate for us most of the time to be in an area maturitywise which corresponds somewhat with what banks are using for their own reserve purposes. To some extent, that is, bills, it is the main vehicle that you might think of as a vehicle for balancing liquidity positions of banks, but the banks, of course, are in intermediate maturities in a rather big way, and I think that could be adduced as a theoretical justification for having a rather large portfolio in the 1-to-5 area as compared with the 5 years and out.

Representative REUSS. Well, I was with you all the way up to now. However, I am afraid I leave you. I cannot see any particular reason, esthetic or otherwise, for keeping your portfolio in the same proportions as bank reserves. Why? You are not a commercial bank.

Mr. HAYES. No, but our main business is to deal in bank reserves, to influence bank reserves and, therefore, it is often appropriate that we be in the portion of the market where the banks are either liquidating Government securities or taking on Government securities, as a kind of meshing, a complementary aspect to our actions vis-a-vis those of the banks under certain circumstances, not all the time.

I think that that may have something to do; if you were looking for a theoretical justification of that maturity pattern, it could be usefully adduced.

Representative REUSS. My 10 minutes have expired.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. I have no further questions.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Mr. Hayes, what was your background before you came to the Federal Reserve?

Mr. HAYES. I was what I call an international banker. I was in charge of the foreign department of the New York Trust Co.

Senator PROXMIRE. How long have you been with the Federal Reserve?

Mr. HAYES. Five years, approximately, this coming August.

Senator PROXMIRE. The other members of the Open Market Committee have similar backgrounds?

Mr. HAYES. No. I think the Open Market Committee has a great variety of backgrounds.

Senator PROXMIRE. Would you give me an idea of what the backgrounds are? Do you have—are you one of the few people with a commercial banking experience?

Mr. HAYES. I would think I am; yes. I would think I am among the very small minority that has commercial banking experience.

Senator PROXMIRE. What experience do the others have; have they been—are they economists, businessmen?

Mr. HAYES. You have all walks of life, businessmen, economists, professors; many of them are what you would call career Federal Reserve people who went into a bank or the Board at a very early age and have been in the System practically all their working days.

Senator PROXMIRE. They have been in the Federal Reserve bank in many cases from the time they finished college?

Mr. HAYES. I would guess so. I do not have their detailed background.

Senator PROXMIRE. You said, as I understood you to say, your main duty was to influence bank reserves.

Mr. HAYES. Yes, sir.

Senator PROXMIRE. You see the conflict, it seems to me, in my mind, as far as your operations are concerned, it seems to me that may be your main instrument, but your main duty is to serve the economy in terms of growth and stabilization and that kind of thing. I do not want to——

Mr. HAYES. I could not agree with you more, Senator.

Senator PROXMIRE. I do not want to misinterpret——

Mr. HAYES. I think you have to distinguish between what we could call our goals, and our goals obviously are such things as economic growth and stability, reasonably full use of our resources, price stability, the preservation of confidence in the dollar internationally; those are broad goals which we always have in front of us.

But when we come to looking at the ways in which we, as a System, can effect the attainment of these goals, by and large, the most important way we can attain those goals is by having an influence on the banking structure through their reserve position.

Senator PROXMIRE. Yes. Well now, you see the difficulty, I think also is, the fact that you gentlemen, with your varied backgrounds are constantly, day to day, in touch with bankers, and your instruments are banks. The banks object to anything that might have an adverse effect on them, properly so, and you are properly sensitive to it.

But the rest of the people in the economy who have, I think, an interest which might conflict with that of the banks, do not have any such frictional contact with the Open Market Committee. This is where, it seems to me, you might have a somewhat more sensitive feeling toward expanding the money supply by open market operations which benefits all of the American people instead of expanding

the money supply by legal manipulation of bank reserves which benefits the bankers directly and primarily.

As you lower reserve requirements, it seems to me, the benefits go to the banker, by and large and, as you expand the money supply of open market operations, the benefit goes to the whole economy, to the taxpayer.

Mr. HAYES. Well, Senator, I would assure you that our choice——

Senator PROXMIRE. Isn't that correct, in general?

Mr. HAYES. It is not entirely correct because I would think that while most of our earnings go to the Treasury, a great, a large proportion of the earnings of banks also go to the Treasury in one form or the other, taxwise.

Senator PROXMIRE. Well, proportionately.

Mr. HAYES. So the difference is not as great as might appear on the surface.

But I would assure you that our choice of instruments never has as its basis a desire to help the bankers because we are under the influence of the bankers.

I would like to take this opportunity—this is an old subject between Mr. Patman and me—and I would like to take the opportunity to just point out a very few facts about our structure.

Senator PROXMIRE. Very good.

Mr. HAYES. It is true we have nine directors, six of whom are elected by bankers. But three of those six cannot be bankers and, in fact, in our own bank we insist that they not even be stockholders in the bank.

Therefore, there are three bankers on our board, but the other three industrialists selected by the banks cannot have any present interest in banks. Of course, the other three directors are appointed by the Board of Governors.

Secondly, I would say when these directors get on the the Board it is quite clear to me that they try their very dead level best to think entirely in terms of the public interest. Beyond that in the appointment of the officers of the bank, when they appoint the president and the first vice president of the bank, when the directors appoint them, that appointment is subpect to approval by the Board of Governors, which is a Government organization, and if there were the slightest doubt in the mind of the Board of Governors that this man was going to follow the public interest, I do not think they would approve them; I would not want them to.

Chairman PATMAN. May I just make one comment there, Senator Proxmire?

Senator PROXMIRE. I will yield.

Chairman PATMAN. You state three are selected by the banks, that is correct, they are bankers; and then three are not supposed to be bankers, but they may have bank stock. I requested Mr. Martin one time to interrogate them, and a majority of them did own bank stock.

Mr. HAYES. Mr. Patman——

Chairman PATMAN. I understand from what you say you would prefer that they did not, but a majority of them at that time did.

Mr. HAYES. Well, with respect to the directors, I can speak only of our own bank, I do not know the situation elsewhere, but in the New York bank the B directors do not own bank stock as a matter of policy.

Chairman PATMAN. Yes.

Senator PROXMIRE. Then, if I could just follow this up, it would seem to me that in view of the specific benefits of following the open market route of money expansion there should be a clear justification for following a policy of lowering reserve requirements, I just cannot see how lowering reserve requirements benefits the taxpayer except in this indirect way in which, as you say, the banker shares a part of his income with the Federal Government, but there is a direct and virtually complete benefit to the taxpayer by open market operations. This is because the interest accrues to the Federal Government. Therefore, the preferred method for expanding the money supply should be to have the Federal Reserve Board, perhaps, gradually retire the national debt by buying additional Federal securities.

Mr. HAYES. Well, might I, Senator, might I just remind you of one fact, that this decision whether to use reserve requirements changes is not in the hands of the Open Market Committee, it is in the hands of the Board of Governors who are Government officials, and it is a matter of their own wisdom whether reserve requirements are to be used.

Senator PROXMIRE. I undersand that.

Mr. HAYES. It is really, we can have kind of an interest, a side interest in it in the Committee, but we have no responsibility there. So I think it is more appropriate to ask the Chairman of the Board of Governors how he feels about it.

Senator PROXMIRE. I think that is true. We have asked him but, as a very distinguished banker and as head of the biggest Federal Reserve bank in the country, I was very interested in your viewpoint on this because you are a very fairminded man, and you have been enlightening to all of us.

I want to get the other side as much as I can. I know my own viewpoint pretty thoroughly, and I would like very much to get yours.

Mr. HAYES. Well, I think this question of what is the right level of reserve requirements is an awfully tough one. There is no God-given level of requirements that is right and everything else wrong.

Now, we did, as a result of various fortuitous circumstances in the thirties and during the war, we had to raise requirements to the top of the limit provided by statute.

On the basis of the limits that had been set by Congress it looked to us as if those were pretty high figures—I am saying us, I was not in the System when they started lowering them—but those seemed excessively high, perhaps, and it seemed appropriate to get them down to a somewhat lower level.

But I do not know, there is no exactly right level for reserve requirements. You can work with reserves 16½ percent and 12 or you could work effectively with either somewhat lower or somewhat higher requirements as far as monetary policy is concerned.

I would say from my experience with reserve requirements in most other big industrial countries, our requirements are not any easier than the other countries, in general.

Senator PROXMIRE. I see my time is up. I just wanted to see if I could summarize then by saying that you would compare with other countres rather than our historical experience here, and you think the current experience is more pertinent?

Mr. HAYES. Could I ask you to repeat it?

Senator PROXMIRE. My point is, is it or is it not true that from an historical standpoint there has been a tendency to decrease reserve requirements?

Mr. HAYES. There certainly has been in the last decade; but, as I say——

Senator PROXMIRE. I am not talking about the last decade but talking about the historical sweep. You made an excellent statement when you said during the war we had to increase it or get it up as high as we did, and there is a tendency to get them down to a more historical——

Mr. HAYES. I would have to look at the record to see whether the trend over a long period of years since the inception of the system is up or down; I do not really know.

Senator PROXMIRE. Thank you, sir.

Chairman PATMAN. You mentioned about reserve requirements. Now, on time deposits, they are 5 percent uniformly over the country generally, all commercial banks?

Mr. HAYES. Yes, sir.

Chairman PATMAN. And some day they vary. But in determining about a bank's reserve requirements for the whole bank, you just take the 5 percent and the 12 percent, whatever it is, and they are mixed together and they are averaged up, are they not? It is not separately kept such as time deposits and demand deposits?

Mr. HAYES. Well, we make a separate calculation of the reserve requirement on their demand deposits, and the requirement on their time deposits, and then they must keep with us the total of those two separately calculated sums.

Chairman PATMAN. Suppose they had $1 million on time deposits and $1 million on demand deposits in a bank that required 10 percent on demand deposits; the average there would be 7½ percent, would it not?

Mr. HAYES. Yes. They would carry $100,000 against the demand and $50,000 against the time and, of course, that would average to 7½ percent.

Chairman PATMAN. Seven and a half percent.

Mr. HAYES. Yes, sir.

Chairman PATMAN. Now, Mr. Hayes, have you noticed in recent years that the banks have more and more become purchasers of municipal bonds?

Mr. HAYES. I think that they are very important purchasers of municipal bonds, and I am not sure on what the trend is; they certainly favor——

Chairman PATMAN. Do you look with favor on commercial banks buying long-term bonds where the governments are municipals?

Mr. HAYES. I think there is probably a limited place for the purchase of long-term bonds by banks, particularly as they are holders of savings.

Chairman PATMAN. It is rather ironical to me that you take, for instance, people in a school district who vote $1 million worth of bonds, and people have to pay on their tangible property, what you see, the buildings and the land, and they pay that, in order to pay taxes on that, in order to pay the interest and the principal on the bonds.

Many of these people own those homes and farms and plantations, like veterans, can go up to 90 percent of a home, well, they are rendered for taxation as though they owned them, and they pay taxes as though they own them.

Now, they pay taxes on what they owe to pay for the interest and the principal on these bonds, and then the commercial bank manufactures the money, creates the money, to buy those bonds, and they have got nearly a third of all the bonds outstanding, municipals now, the commercial banks now, have acquired in that way, and then when they collect the interest on that, it is paid by this fellow who is paying interest or paying taxes on what he owes. The banks do not even have to pay an income tax on it, do they?

Mr. HAYES. That is correct.

Chairman PATMAN. I think the banks are making a serious mistake there. They have gone more into the business of making money on tax-exempts, I mean too many of them are, and neglecting the local community or area that they are chartered to do business in, and I think the examiners are responsible for it, to some extent.

But all the bankers are not blameless, and I think they are making a terrible mistake. They are forgetting the local people, and the people in the area. They will not even make a farm loan any more. We have to have a Government agency make a farm loan.

They have gone out of the banking business in many respects, and, therefore, we have to have the Federal Savings and Loan, we had to have other institutions similar to commercial banks to make loans to people, and loan offices of different kinds springing up all over the Nation, and the credit unions are taking the country like wildfire, and I think it is all because the bankers are not carrying out their duties and responsibilities to the public in the local areas, where they are chartered to perform a real duty and service.

I want to see them make money. I believe in a profitable banking system. I want to see them make good money because we have got to have good banking institutions. We cannot get along without them, and they have been wonderful both in time of war and peace, and I am not criticizing them for that, but commending them for it.

They have gotten away from the banking business, and gone too much into the long-term obligations, too much into the tax-exempt securities, and I think it is really there that you consider they abuse it. I would not say immoral and dishonest because they have a right to do it. They are not violating any law, but I do not think that they should do it. I think it is wrong.

Mr. HAYES. Could I comment, make one brief comment, Mr. Patman?

Chairman PATMAN. Yes.

Mr. HAYES. I do not know which banks or which parts of the country you are speaking of.

Chairman PATMAN. I will say all of them.

Mr. HAYES. I am sure you are more familiar with many parts than I am.

Chairman PATMAN. All sections of the country.

Mr. HAYES. My observation in our own district, I would think, is the banks are pretty aggressive in going after loan possibilities locally, and I would point out that their loan deposit ratios are at a

higher level than they have been for many, many years. Our banks, in general, are loaned up to 65 percent.

Chairman PATMAN. That is fine. They have mutual savings banks in your areas, they have more competition than the rest of the country; the rest of the country does not have it.

Mr. HAYES. We have plenty of competition, and I think it is a healthy thing.

Chairman PATMAN. That is right. And the credit unions are coming in, they are being organized everywhere, and they are increasing all the time. I think it is due to the fact that the bankers are not looking after their own people too well, and they are going after tax-exempt bonds some other place.

Are there any other questions? Do you have some more questions, Senator Proxmire?

Senator PROXMIRE. I have a couple more.

Chairman PATMAN. Go ahead, Mr. Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Back to our portfolios. You said before, Mr. Hayes, that there was a theory that the Federal Reserve's portfolio ought, somehow, to have a banking flavor to it, I forget exactly how you put it; it ought to resemble the loan pattern of the commercial banks.

Mr. HAYES. No. What I was saying, since our main objective is, I should not say "objective," but our main instrumentality, for the attaining of our objectives is our influence on bank reserves, bank reserve positions, and since banks in adjusting their money position use short-term and intermediate securities almost exclusively or to a very large extent, there is a certain logic to our dealing in the kind of securities in which they are making their—adjusting their position.

Representative REUSS. Do you subscribe to this yourself?

Mr. HAYES. I think there is some logic in it. I am not expert on this, and I would defer to the economists on this as to whether—how cogent an argument it is. I do not want to overstress it.

Representative REUSS. It does not sound the least bit cogent to me, very frankly, although I welcome you or anybody else showing me there is anything in it. Why not conform your portfolio to the public holdings of these various issues?

Mr. HAYES. Well, I simply, as I say——

Representative REUSS. That makes just as much or maybe a little more sense.

Mr. HAYES. Well, I think, as we say, we exist to operate on the reserve position of the banks, that is our sole way or our major way—I won't say our sole way—our major way of influencing the economy, and by the nature of our operations, we are a central bank, which means we are the holders of the reserves of the banks, and as we try to influence their reserve position, it frequently is convenient to, from the standpoint of market balance and market conditions—and again I say I am not a technician on this—to be dealing in the same types of maturity which they are using to balance their position.

Representative REUSS. I find this somewhat inconsistent with my sensing of what you said before, and I agree with it, that the main instrument for open-market operations should be in the very short-term, 90-day bills.

The fact that banks happen to hold, and I guess they do, considerable amounts of 1- to 5-year securities does not seem to me to militate in favor of making 1- to 5-year securities an important instrument of open-market, day-to-day operations; does it, in your mind?

Mr. HAYES. Well, I still stick to my original statement that the main thing is to deal in the shortest securities, the bills, for a variety of reasons, and this is purely a secondary consideration.

Representative REUSS. Yes. If so, then I cannot, for the life of me, see why it should be the unalterable law of the Medes and Persians as far as the Federal Reserve is concerned, that you have got to have $10 billion worth of 1- to 5-year, and only $7 billion worth of 1- to 90-day notes.

Mr. HAYES. I quite agree with you, Mr. Reuss. I did not mean it was an unalterable law of the Medes and Persians.

Representative REUSS. One more question in this connection. You mentioned, Mr. Hayes, that long-term Federal securities, of course, tended to fluctuate more than short term, and that this was a fact to be taken into account, and I certainly agree with you.

However, no one, certainly not I, is suggesting that the Federal Reserve should suddenly go in and out of the market with long-term securities.

If a long-term security is held until maturity, of course, then there is no problem, is there? It pays off, and always has, 100 cents on the dollar.

Mr. HAYES. That is correct.

Representative REUSS. So if it is possible to keep long-term securities, if need be, in the Federal Reserve portfolio until they mature, then there is no problem as to fluctuation; is that not so?

Mr. HAYES. That is correct.

Representative REUSS. What this all boils down to, it seems to me, Mr. Hayes, is a consensus between you and me, at least, that there might be much good in greater flexibility in the Federal Reserve's portfolio, consistent always with the major monetary and credit objectives. There is no law of nature which says that the current portfolio distribution that we have on the blackboard there is the one and only.

Mr. HAYES. I would quite agree with that statement, Mr. Reuss, and I would think that the composition of it results to a considerable extent from war financing. It is just happenstance.

Representative REUSS. Well, if that is so, why is it not a matter of urgency for the Open Market Committee at its next meeting to address itself to the request of this Joint Economic Committee majority made a year ago, in January 1960, in its report, in which it asked the Federal Reserve System to abandon its inflexible portfolio policy and, at least, to weigh the desirability of changing its portfolio alinement?

If this request of the Joint Economic Committee is followed, it seems to me that it is up to the Open Market Committee promptly to repeal paragraph c on page 48 of the report, and I would hope that this matter would be brought up very promptly, and that the Open Market Committee will give the Joint Economic Committee the benefit of its views on this.

In other words, if you agree with the Joint Economic Committee, then you ought to speedily repeal paragraph (3).

If you do not agree, then it seems to me you ought to tell us why, and your answer on that ought to be directed at the issues that have been raised in our conversation here this morning.

Mr. HAYES. Well, Mr. Reuss, obviously I cannot speak for the committee, and also quite obviously from the record I am not always in agreement, I have not always agreed entirely with the committee on this subject of flexibility.

I am entirely in agreement that we should have maximum flexibility, but I would still like to stress that the reason I want that flexibility is primarily so that we can deal in the most efficient manner with the monetary problems day to day, week to week, and month to month, and I regard the portfolio composition as a decidedly secondary consideration.

I would think that subject to that proviso there are opportunities, perhaps, for having a better portfolio distribution than the one we have. I see nothing ideal or God given about that particular structure.

Representative REUSS. Well, I agree with you perfectly, Mr. Hayes, and I accept your primary emphasis on monetary and credit policy, with debt management definitely in secondary position, but nevertheless entitled to consideration where it does not interfere with your primary monetary interest.

But the fact is that the law of the Medes and Persians now on the Federal Reserve statute books says that you cannot do this, and while I appreciate your position and applaud your vote on March 1, 1960, I would hope that as vice chairman, you would bring to the attention of its next meeting and successive meetings until some action is taken, the views that have been expressed here today. They are the views of the majority of the Joint Economic Committee, as well as my own views, because this has been substantially embodied in our report of a year ago, with a request that the Open Market Committee, which is, as you have pointed out this morning, a creature of Congress, either adopt the suggestion of the majority of the Joint Economic Committee or tell us why they have not.

That seems to me to be a reasonable request to pass on. I appreciate your position, but will you be able to pass that on to your colleagues?

Mr. HAYES. I would be glad to try to pass that on, Mr. Reuss.

Representative REUSS. Thank you very much.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. Mr. Hayes, I would appreciate it very much if you could provide for me any material at all that you have knowledge of that would give justification for using reserves, the decrease in reserve requirements, to increase the money supply, rather than open market operations. I do not want to belabor the point further, but it seems to me the argument in favor of open market operations is so clearly in the interest of the taxpayer and in the interest of the general citizen——

Mr. HAYES. Well, Senator, let us take a situation where you were facing a rather depressed set of circumstances economically, and you wanted very much to ease the pressure on the banking positions quickly and throughout the country.

Now, when we operate in open market, through open market operations, the impact is, in the first instance, in the money markets. The effect on reserves gradually spreads through the entire banking sys-

tem, but it depends on a lot of variables whether that influence is felt promptly or not throughout the country.

Whereas, if you tell every bank in the country that as of a certain date. "Your reserve requirement is not going to be 12 percent, but 10 percent," just to take a number out of the air, that means that every bank in the country as of that day suddenly is in a position to lend a lot more to its customers, and to act as an expansive influence, doing what credit can do to try to encourage greater expansion.

So I think——

Senator PROXMIRE. Do you have a study of that to indicate any precise difference or any general difference in timing so that you can show that as a matter of fact you can get a far more prompt or, to any extent a prompter, reaction to lowering reserve requirements than you can in buying Federal obligations?

Mr. HAYES. I would suggest that we would be glad to make a study or try to prepare some memorandum on our experience.

Senator PROXMIRE. I think a memorandum of that kind would be extremely useful, very, very useful.

Mr. HAYES. I will try to get our research people to work on it.

Senator PROXMIRE. Very good; expanding the answer to that question any way at all they would like to justify that position.

(The information referred to was subsequently submitted for the record as a joint reply with Mr. Martin and appears in the testimony of Chairman Martin at p. 170.)

Senator PROXMIRE. You are familiar with Dr. Milton Friedman of the University of Chicago, an economist, quite a conservative economist?

Mr. HAYES. In a very general way. I do not know him.

Senator PROXMIRE. Well, Dr. Friedman has taken a position for which, I must say, I have sympathy, that the Federal Reserve Board has often been wrong; they are always leaning the wrong way; they lean with the wind, but the wind is coming from the wrong direction.

He argues that there is a lag of several months between execution of policy by the Federal Reserve and its effect on the economy; but by the time the impact of what they have done has its effect, the wind is blowing the other way.

Now, does the Open Market Committee itself decide to accept or reject the judgment of economists as to what action is desirable to stabilize the economy or to make the economy grow?

Mr. HAYES. Yes, I would say we go to tremendous trouble.

Senator PROXMIRE. This is the Open Market Committee, not the Board of Governors that does this?

Mr. HAYES. Yes, sir. I would say the Committee goes to great pains to try to keep up with the latest thinking on everything involving monetary policy, everything concerned with monetary policy; and we, of course, have several economists associated with the Committee, not only Board economists but economists of the various Federal Reserve banks, who are constantly reviewing the latest thinking on these subjects and giving members of the Committee the benefit of their thinking on it, the benefit of their impressions on it.

Senator PROXMIRE. So the Open Market Committee's decision as to, whether to, buy or sell and so forth is a decision that is made on the basis of the Board of Governors' decision in the first place as to

whether or not to use open market operations, and then in terms of judgment the Open Market Committee's views on the economy——

Mr. HAYES. No. The Open Market Committee itself, not the Board of Governors, decides whether to use open market operations and in what way.

Senator PROXMIRE. I see.

Now, I am sure you are familiar with the disagreement between Mr. Tobin of the Council of Economic Advisers and Mr. Martin, Chairman of the Federal Reserve Board on the nature of our present unemployment?

Mr. HAYES. I have just followed it in the press a little bit.

Senator PROXMIRE. Well, they both present conflicting views following each other before this committee, and the view of Mr. Tobin, as expressed initially in his appendix to the Council of Economic Advisers' report was that unemployment was very largely a matter of demand, and while there was structural unemployment, and it was important, and it was difficult, that it would be possible to reduce unemployment to 4 percent from 7 percent without any very greatly inflationary impact.

Now, the Chairman of the Federal Reserve Board did not use figures, but he did put far greater emphasis on structural unemployment, and he indicated this was a hinderance in the way of the Federal Reserve Board's using monetary policy.

To move the economy ahead as rapidly as he would like, he indicated, I think, two hindrances primarily. One was the outflow of gold, and the other was structural unemployment, and I notice in your report on page 7 there seems to be an endorsement of this viewpoint, although the language is quite general.

Now, is this your position, that it is quite difficult under the present circumstances, even though we have had a continuous, almost 7 percent unemployment. May was just about as high, seasonably adjusted, as April; April as March, and so forth. Is it your position that monetary expansion is a very limited solution to the unemployment problem because of the structural nature of this unemployment?

Mr. HAYES. Well, first, Senator, let me say that I am, by no means, an expert in this field.

I would think myself that there were elements of truth in both explanations of the unemployment situation.

I am certainly disturbed by the high level of unemployment. I think all of us are in the System, and we would like to figure out ways of helping to reduce that. There is not any question about that.

I think we also feel that there is an element of structural unemployment that probably has to be dealt with in ways other than through monetary and credit policy.

Furthermore, I would stress my own view that in trying to use monetary and credit policy to help remedy that very deplorable situation, we have to bear in mind constantly what effect our actions are having on other goals of equal importance in the economy and, notably, let us say, on prices.

Fortunately we have not had pressure, inflationwise, in the last year in anything like the way we had it, say, in the preceding 12 to 18 months.

Senator PROXMIRE. If I can interrupt right at that point, No. 1, the price index has been extremely stable in the last 3 or 4 months.

Mr. HAYES. Yes.

Senator PROXMIRE. In the second place, I was very much impressed by the statisticians who appeared before our Statistics Subcommittee, who insisted there is a bias in the cost of living index which does not allow for the improvement in quality, so there is probably a real decline in the cost of living over the past 3 or 4 months, if anything.

Mr. HAYES. I hope and believe that may well be possible.

Our economists are studying that, as well as a lot of other economists, and I would take some encouragement from that development.

However, I would point out that the danger of inflationary influence is cropping up again, is something we cannot overlook, and I think it is something that is very much on our minds, and it is in the minds of central bankers all over the world, certainly with reference to this country.

Now, I have been very much encouraged by some of the administration's pronouncements recently indicating that they are very concerned over the necessity for keeping our cost structure in this country highly competitive, and trying to keep prices and wages in some stable range, and avoiding the inflationary problems we have had in the past.

I am merely bringing this out because it has a bearing on what we can do to remedy unemployment.

The more other elements in the economy that can contribute to preventing these inflationary dangers from cropping out, the more we can relax on the monetary side and try to contribute to expansion and the solution of the unemployment problem.

Senator PROXMIRE. It seems to me this is the toughest economic problem that faces us, by far. It is a problem that is more difficult than it has been because we have this vast increase in automation which, I think, is much more sudden now than it has been, that is, looking at it for the past 10 or 11 years, on the farm and in industry. Secondly, we are bound to have a greater increase in the work force over the next few years, and in view of the fact, as you agree, we have a stable price level, and considerable effort on the part of the administration to persuade labor and management to keep prices as low as they can, and keep wages from pushing prices up, it would seem to me maybe we can move ahead by expanding the money supply, especially in view of the fact that the ratio between the money supply and the gross national product is now about as low as it has been for 30 years—you have to go back to 1927 to find a relationship which has been this conservative.

I would just like to ask one final question, and I apologize for having detained you. This refers to the question that the chairman, Chairman Patman, asked earlier with regard to the surplus of the Federal Reserve Board.

You said it was conceivable that the Federal Reserve might have to dip into its surplus. Let me ask you, has the Federal Reserve Board ever, in all of its years of operating since 1914, including years of terrible depression, had to dip into its surplus?

Mr. HAYES. I do not know of any instances myself. I would doubt it, because our current earnings from, our current annual earnings from, the portfolio yield are always very ample to take care of any losses of any kind that have been incurred during the year, and those losses, to the best of my knowledge, have been very small, if any, in any given year.

Senator PROXMIRE. From an historical standpoint, the position taken by the Chairman would seem to be a fairly persuasive position, that you could reduce at least somewhat your surplus.

Mr. HAYES. Well, as I pointed out, we have reduced it, we made quite a sizable contribution to the Treasury last year, something close to $1 billion, and the surplus is still pretty big.

Senator PROXMIRE. It is still pretty big.

Mr. HAYES. But I would submit that the capital and surplus is not very big either in relation to our total position and the actions we have taken.

Senator PROXMIRE. But you could always go into the capital stock.

Mr. HAYES. Yes, but I think there is enough of a tradition in this country that an organization which has capital stock should not impair its capital, and I think it is well worth—it is probably of real benefit to the impression of strength and integrity of the organization that they should not have to impair capital.

Senator PROXMIRE. Thank you very much, Mr. Hayes, and I want to thank you so much for staying so long and yielding to me when I have taken so much of your time.

Mr. HAYES. Thank you, Senator.

Chairman PATMAN. You state it is a good impression to have capital stock and surplus; that it is traditional. That is true.

But I think it is kind of a make-believe, Mr. Hayes. We do not need it; it is phony. You won't ever have to dig into your surplus, you will never have to dig into your capital stock; neither one has ever been used. We have had testimony on this.

Different members of the Board have testified that capital stock is there idle, it is unused. The Government is paying 6 percent interest on it when it should not be done. That surplus is not used, it will never be needed, because you do not need surplus when you can create all the money that you use. That is what you do, just create the money. That is the way you are set up by Congress to do, and I cannot conceive of the Federal Reserve objecting to turning over more of that $800-and-some-odd million when they do not use it, will never have a need for it, never have used a dime of it, and will never have need of it.

I think it is a great detriment when they have to pay $30 or $40 million a year of the taxpayers' money just to let the Federal Reserve keep some idle money, and they are not using it at all.

Mr. HAYES. Mr. Patman, might I point out that the asset counterpart of the liability—and surplus is a liability—is that you can probably consider that part of our portfolio of earning assets is allocable to that surplus, so we are earning money on those funds, and most of those earnings are going to the Treasury.

Chairman PATMAN. That is a bookkeeping deal. You say you are earning money on that surplus?

Mr. HAYES. We are earning money on the assets.

Chairman PATMAN. What right do you have to use that surplus? You have no need for it. You create your money.

Mr. HAYES. I hope we will have no need for it, Mr. Patman.

Chairman PATMAN. You admit you have no need for it.

Mr. HAYES. I hope we will not have to dip into it, but I think it is a useful thing to have on the books.

Chairman PATMAN. I just want to bring up one point and then I am finished, Mr. Hayes.

Under the subject of urgent national needs the President of the United States on May 25, 1961, made a speech to economists. In that speech I shall read you one excerpt:

> The full financial influence of Government must continue to be exerted in the direction of general credit ease and further monetary growth while the economy is recovering. Some further downward adjustment in interest rates, particularly those which have been slow to adjust in the recent recession, are clearly desirable, and certainly to increase them would choke off recovery.

Now, has the Open Market Committee considered this request of the President?

Mr. HAYES. I think that is a question you should address to the Chairman, Mr. Patman.

Chairman PATMAN. Well, you are a member of it, and vice chairman.

Mr. HAYES. To the best of my knowledge, it has not considered it in any official way. I think everybody has read the papers and seen the pronouncement.

Chairman PATMAN. Do you think that the Open Market Committee will go along with this expression of hope or request——

Mr. HAYES. I think——

Chairman PATMAN (continuing). Of the President?

Mr. HAYES. I think it would be quite improper for me to try to indicate here what the policy of the Open Market Committee might be with respect to interest rates from now on.

Chairman PATMAN. Well, I will not press you on that point, but I hope you keep it in mind. I think that the President of the United States, under the Constitution, is dutybound to take care that the laws are faithfully executed. The Federal Reserve Act is a law just like any other law, and since the President of the United States has asked you gentlemen, this is what I consider a direct statement to the Federal Reserve System, the Federal Reserve Board and the Open Market Committee, in particular, to, "Not choke off recovery by easing credit"——

Mr. HAYES. Let me say this, Mr. Patman, I have the utmost respect for the President and the utmost respect for anything he says. But I would also like to point out that in the wisdom of Congress they set up the system in such a way that the system is not under the instructions of the executive branch of the Government.

Chairman PATMAN. Listen, you are seceding more than you have ever seceded. I thought you seceded pretty well on March 4, 1951, but you are going further, I think, than you did then.

Mr. HAYES. I did not think we are seceding at all, Mr. Patman. I am merely pointing out——

Chairman PATMAN. I do not agree with you at all on that, Mr. Hayes. I have great respect for you. I think you are a mighty fine, public-spirited citizen, earnest and sincere in performing your duties in the way that you feel is an honest and sincere approach, and the way to do it, and I am not questioning your motives in any way.

But I think you made a very bad statement there when you, in effect, said that the President has not anything to do with the Federal Reserve.

Mr. HAYES. I did not mean to say he had nothing to do with it, sir.

Chairman PATMAN. What do you mean that he has to do with it?

Mr. HAYES. I mean that the System is set up in such a way at the volition of Congress that in its determination of policy it is supposed to arrive at the decisions on those policies on its best judgment and not under the instructions of the executive branch of the Government.

Chairman PATMAN. With your decisional part I would agree that you are correct, but I am not talking about the decisional part.

Mr. HAYES. I can assure you, I would like to make one additional statement, I can assure you we would pay a great deal of attention to anything coming from the administration, particularly and obviously at that level, or from any high level of the administration.

Chairman PATMAN. I wish you would cite the law that gives the Federal Reserve or the Open Market Committee, in particular, the power to determine monetary policies.

Mr. HAYES. Well, I will have to submit a memorandum on that, if you wish it. I cannot cite the law, unless my legal associates can.

Chairman PATMAN. Well, you have your legal counsel. Perhaps your legal counsel can.

Mr. CLARKE. Section 12A of the Federal Reserve Act constitutes the act of Congress which sets up the Federal Open Market Committee, and defines the scope of its duties, Mr. Chairman.

Chairman PATMAN. Well, name the one which would justify you in saying that it includes monetary policies.

Mr. CLARKE. Unfortunately, sir, I do not have with me a copy of the Federal Reserve Act.

Chairman PATMAN. I have a copy of it here, but if you prefer to take time to look it up, you may submit it for the record; but I do not think you will find that you have that authority in the law.

(The following was later received for the record:)

FEDERAL RESERVE BANK OF NEW YORK,
New York, N.Y., June 13, 1961.

HON. WRIGHT PATMAN,
Chairman, Joint Economic Committee, Congress of the United States, New Senate Office Building, Washington, D.C.

DEAR MR. PATMAN: This letter refers generally to the hearings held by the Joint Economic Committee on June 1–2, 1961, with reference to recent policies and actions of the Federal Reserve System, and in particular to the following question asked by you of Mr. Hayes during the morning session of the June 2 hearing (vol. 2, p. 190, transcript of hearings):

"Chairman PATMAN. I wish you would cite the law that gives the Federal Reserve or the Open Market Committee, in particular, the power to determine monetary policies."

Owing to the fact that a copy of the Federal Reserve Act was not available in the hearing room at the time, no complete response to your question was made. For the purpose of completing the record, I should like to submit the following as an extension of my remarks at that hearing.

During the hearings on the financial condition of the United States conducted in August 1957 by the Committee on Finance of the U.S. Senate (85th Cong., 1st sess.), Senator Malone asked Chairman Martin a question substantially similar to yours (hearings, pt. 3, p. 1518); and Mr. Martin later inserted in the record the following information which appears on pages 1518–1519 of the hearings:

"The Federal Reserve Act does not contain any provision specifically stating that the objective of the Federal Reserve System is to promote conditions that will foster sustained economic growth and stability in the value of the dollar. However, this objective is implicit in the title of the act and in policy directives contained in various provisions of the act; and, taking such directives together with the declaration of policy contained in the Employment Act of 1946, it is

clear that the promotion of credit conditions conducive to economic growth and the maintenance of the stability of the dollar is one of the most important objectives of the Federal Reserve System.

"The Federal Reserve Act is entitled 'An act to provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.'

"The law provides that discount rates shall be established by the Federal Reserve banks, subject to review and determination by the Board of Governors, 'with a view of accommodating commerce and business' (12 U.S.C. 357).

"The Board is authorized to change reserve requirements of member banks 'in order to prevent injurious credit expansion or contraction' (12 U.S.C. 462b).

"The operations of the Federal Open Market Committee are subject to provisions of the law which require that the time, character, and volume of all purchases and sales in the open market 'shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country' (12 U.S.C. 263).

"The board of directors of each Federal Reserve bank, in extending credit to member banks, is enjoined to consider 'the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture'; and each Reserve bank is required to keep itself informed of the general character and amount of the loans and investments of its member banks 'with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions' (12 U.S.C. 301).

"In prescribing margin requirements for purchasing and carrying securities, the Board is required by the Securities Exchange Act of 1934 to consider whether such requirements are 'necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country' (15 U.S.C. 78g).

"The various policy directives which have been given by Congress to the Board, the Open Market Committee, and the Federal Reserve banks are more fully discussed in Chairman Martin's replies to the 1952 questionnaire of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report. These directives, as previously indicated, implicitly place upon the Federal Reserve System a responsibility for promoting monetary and credit conditions conducive to economic growth and maintenance of stability of the value of the dollar. That objective is supported by the declaration of policy contained in section 2 of the Employment Act of 1946, which reads as follows:

" 'SEC. 2. The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchaing power' (15 U.S.C. 1021)."

As you know, one of the questions addressed to Chairman Martin in 1951 by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report related to the matter of congressional policy directives addressed to the Board of Governors, the Federal Open Market Committee and the Federal Reserve banks. Chairman Martin's reply thereto, transmitted to you, as chairman of that subcommittee, under date of January 29, 1952, appears at pages 207–239 of the "Compendium" issued by the subcommittee. I would refer to that reply for a fuller discussion of the subject.

The report issued by the subcommittee, over date of June 26, 1952, contained material, at pages 39–41, under the heading "Congressional Mandates on Economic Policy." Excerpts from this material follow:

"The congressional mandates to the Treasury and the Federal Reserve System setting forth the economic objectives toward which they should strive are vague and diffuse. This is shown clearly in the replies of the Secretary of the Treasury and the Chairman of the Board of Governors to questions asking them to describe the economic policy directives given them by Congress and the economic

policies which they are actually following ("Compendium," pp. 1–17 and 207–239). Each agency affirmed that, in addition to directives contained in legislation applying specifically to it, it considered itself bound by the congressional declaration of policy set forth in the Employment Act of 1946. The great majority of witnesses, both governmental and nongovernmental, who appeared before the subcommittee expressed their sympathy with the purposes of the act and their belief that all governmental agencies, including the Federal Reserve System, were bound by the declaration of policy included in the act. * * *"

"There was much disagreement among the witnesses before the subcommittee concerning the practical importance of revising the Congressional mandates governing economic policy. Some believed that a revision of these directives was a matter of great urgency, while others believed that it was of little practical importance. * * *"

"As a matter of good legislative practice, the subcommittee believes that the economic policy directives given by Congress to both the Treasury and the Federal Reserve System should be clarified, but is inclined to hold with Dr. Goldenweiser that the matter is not one of great urgency. * * *"

"The subcommittee believes that the best approach to clarifying congressional policy directives to the Treasury and the Federal Reserve System would be through a revision of the congressional declaration of policy in the Employment Act of 1946, which constitutes a directive to all agencies. Although it approves of the working interpretations put on this declaration by the principal governmental agencies, it feels that, on the face of its actual wording, there is an overemphasis on the maintenance of high-level employment and an underemphasis on the maintenance of price stability. It suggests that further studies be made of this wording with a view to securing a more balanced emphasis."

Respectfully,

JOHN J. CLARKE,
Assistant General Counsel.

Chairman PATMAN. Anyway, Mr. Hayes, we always appreciate your testimony, and we want to thank you for coming here. You have been very helpful to us.

Mr. HAYES. Thank you, Mr. Patman. I appreciate the opportunity.

Chairman PATMAN. At 2 o'clock we will have another meeting, and Mr. Martin will be our witness here in this room.

(Whereupon, at 12:15 p.m., a recess was taken until 2 p.m. the same day.)

AFTERNOON SESSION

Chairman PATMAN. The committee will please come to order.

Mr. Martin, do you have a prepared statement?

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH A. YOUNG, SECRETARY, FEDERAL OPEN MARKET COMMITTEE

Mr. MARTIN. No, I do not have a prepared statement, Mr. Chairman. I thought, inasmuch as you have had two of my associates up already, that I would spare you a prepared statement and just submit myself to question.

Chairman PATMAN. That is satisfactory. Of course, we are always glad to have statements from you.

Mr. MARTIN. I would like to say, if I may, by way of introduction, that I welcome this opportunity to come up and discuss with you our annual report to Congress. We put a lot of work into the report, and we appreciate the opportunity to discuss it.

Chairman PATMAN. Thank you, sir.

Of course, now, the reporter has your name, William McChesney Martin, Chairman of the Board of Governors, Federal Reserve System. But you might identify your associate if you will, please, sir, for the record.

Mr. MARTIN. Ralph A. Young, Secretary of the Federal Open Market Committee.

Chairman PATMAN. Mr. Reuss, would you like to interrogate Mr. Martin? Go right ahead, sir.

Representative REUSS. Good afternoon, Mr. Martin and Mr. Young. I would like to call your attention, Mr. Martin, to the action of the Federal Reserve Open Market Committee of October 25, 1960, which is set forth on pages 67 to 70 of the annual report. The action that day was to add the words, "while taking into consideration current international developments." That language, as I understand it, was on that day added to the marching orders.

Mr. MARTIN. That is correct, Mr. Reuss.

Representative REUSS. And I take it the international developments referred to, as I remember what was going on last October, were the gold outflow and the upsurge in the price of gold in London, Zurich, and other places from around $35 an ounce to $40, $41, or whatever it was.

Mr. MARTIN. That is correct.

Representative REUSS. I call your attention to the fact that in July 1960, the gold outflow of our country started accelerating at quite a rapid rate; it was $178 million in July, $138 million in August; it went up to $320 million in 1 month, the month of September; and in October it was at the rate of $282 million.

I call your attention further to the fact that in June of last year, in June 1960, Germany raised—West Germany raised the bank discount rate from 4 to 5 percent, and the United Kingdom raised its rates from 5 to 6 percent.

In the light of all these circumstances, why did you wait—why did the Open Market Committee wait until October 25 to take into account international developments? Why didn't you do it earlier, and would not an earlier change in emphasis from an open market policy of restricting yourself to only the very shortest term securities have produced a better result?

Mr. MARTIN. Hindsight is always a good thing, Mr. Reuss; but let me say that we actively discussed this matter during the entire period.

You will recall the Federal Reserve reduced its discount rate early in June, and embarked on an easy money policy because of slack developing in the U.S. economy, and although we were aware of the international repercussions, and worried about the possible outflow of capital, we were willing to assume that risk of further outflow up until the October meeting in the interest of helping stabilize the domestic economy. That was our point of view, and that was our conviction.

Representative REUSS. Well, I do not want to suggest for a moment any quarrel with your easing money in June 1960 for domestic reasons, I certainly agree that that was necessary.

However, would not an abandonment of the so-called bills-only policy at that time have allowed you to put whatever additions to bank reserves you felt were needed for domestic monetary reasons into the System, and at the same time avoid concentrating your purchases of U.S. securities on the short end of the spectrum? Wouldn't that have been a more propitious way of handling it?

I appreciate that this is hindsight, but we learn for the future out of the history of the past, and I thought we should explore it.

Mr. MARTIN. It is a matter that should be carefully explored and considered in the light of all the conditions.

Now we have been experimenting with a new technique here recently. Whether that technique should have been adopted earlier and would have been successful at that time is a matter on which it is very difficult to make a good judgment.

Representative REUSS. I suggest to you though that if you had bought fewer very short-term securities, 30-, 60-, 90-day securities, and somewhat more intermediate-term and long-term securities, coming out the same in either model in terms of the amounts that you bought; that is, the amount of new reserves that you brought into the System, we would have been better off, and the short-term rate in this country would not have gone down as much as it did. The incentive to export short-term capital from this country would not have been as large as it was; the resulting gold outflow would have been less than it otherwise would have been.

I am not suggesting that action by the Open Market Committee in and of itself could have avoided all of the troubles that ensued in September and October, but might it not have been somewhat better?

Mr. MARTIN. It is possible. Let me simply say we did not know at that time that two foreign central banks were going to move in the opposite direction. This and the attendant circumstances of the period, such as the speculative furor that was created by our own political campaign and by other causes of one sort or another, were all factors that came into play during the period; and while it is possible that we would have had less pressure on the bill rate by using the technique that you suggest, it is a matter of degree. That is the point that I want to make.

Representative REUSS. By the reference to the political campaign, are you referring to Secretary of the Treasury Anderson's statement in October that the election of Mr. Kennedy would cause a debasement of the currency?

Mr. MARTIN. I am not referring in any terms of partisan politics. I am just referring to the active discussion that went on during the political campaign.

Representative REUSS. The action by the British and West German central banks of raising their discount rate was in June, was it not?

Mr. MARTIN. That is correct. It came immediately or shortly after we lowered our rate.

Representative REUSS. Had there not been incorporated in the policy directives of the Federal Reserve Open Market Committee in June the prohibition on dealing other than with short-term securities, action might have been taken, might it not, in July or August to ease up on the purchase of short-term securities and concentrate purchase instead on longer term securities, and thus avoid a disparity between

our interest rate and the West German and United Kingdom interest rate?

Mr. MARTIN. Interest rates do not necessarily move—the arbitrage works from the short end of the spectrum and the long end of the spectrum, both in varying degrees of speed. No one can be sure in a market overall how this arbitrage will work.

As to what happened during that period, at any meeting of the Open Market Committee—the Committee can change its technique or change its operating procedures or instruct the account manager to operate in a different way than he was instructed at the previous meeting. But there was nothing in our assessment of the thing that caused us, as a Committee, to believe that there was any necessity for change in technique at that time.

Now I have already conceded to you that on the basis of hindsight it is possible that we might changed that directive of October 25 slightly earlier, but that again is hindsight.

Representative REUSS. My time is up.

Chairman PATMAN. Senator Bush?

Senator BUSH. Mr. Chairman, I am sorry I was not here to join you in welcoming the Chairman of the Federal Reserve Board. I am sorry I missed the opening questions. Have you been questioning the Chairman?

Chairman PATMAN. I have not; no, sir. Mr. Reuss just started and he finished, and you are next, and then I expect to ask him a few questions after you are done.

Senator BUSH. Governor Martin, I think you know, and the committee knows, that I am one who believes very much in the independence of the Federal Reserve System and its responsibility to the Congress, and it is a creature of the Congress, so to speak, and I approach this question in that point of view, as one who respects the independence of the Federal Reserve Board very much, and believes it is very important.

But in President Kennedy's recent message in connection with our "urgent national needs," and those three words are from his address, he made this statement, and I will read it:

> The full financial influence of Government must continue to be exerted in the direction of general credit ease and further monetary growth while the economy is recovering. Some further downward adjustments in interest rates, particularly those which have been slow to adjust in the recent recession, are clearly desirable, and certainly to increase them would choke off recovery.

The President has also indicated that he thinks that we are definitely moving out of the recession, and other statements which he has made indicate that the administration believes that the gross national product will be attaining new high levels toward the end of this year, and maybe substantially higher than were attained last year.

And so confident are they in that belief that this is at least a partial justification in their minds for some largely increased spending programs which, it is said, would result in increasing tax income to the Government and, therefore, we can go ahead with these larger spending programs because of not being fearful of the deficit, because the increase in gross national product will produce greater earnings and we will not have a deficit. That is the general idea.

Now he says:

The full financial influence of Government must continue to be exerted in the general direction of general credit ease and further monetary growth while the economy is recovering.

I do not know how long he means, whether to the very end of the recovery, but it is a statement that disturbs me somewhat, feeling as I do that monetary policy should be used with great restraint in respect of stimulating a recovery that already appears to be well underway, and gives promise of going quite far in a favorable direction.

I wonder whether you would care to comment on that from the point of view of the Federal Reserve Board, and especially whether you feel that some further downward adjustment in interest rates, particularly those which have been slow to adjust in the recent recession "are clearly desirable and certainly to increase them would choke off recovery," would you care to comment on this, sir?

Mr. MARTIN. Yes, I will be glad to comment on it.

In the first place, the Open Market Committee and the Federal Reserve will carefully consider anything that the President of the United States says at any time, and we welcome his views.

Now when it comes to this matter of forecasting the future——

Senator BUSH. The what?

Mr. MARTIN. When it comes to the matter of forecasting the future, you have got a great many imponderables that nobody can state precisely.

Now on interest rates, as I have stated a great number of times, our role in the Federal Reserve—and he is talking there about the full financial resources of the Government, of which there are many outside the Federal Reserve, take the home credit field, for example, or various other things—but the Federal Reserve has the obligation to supply bank reserves to the economy, not to fix any levels of interest rates but to supply bank reserves to the economy, in such a way as to help the economy have stability and growth. The Federal Reserve should always seek whatever level of reserves in its judgment is appropriate to that objective.

Now you cannot have high or low interest rates per se without relating them to the flow of funds, and when you talk about interest rates in this sense, levels of interest rates, you have got to relate them to the flow of funds.

I have used the word picture of a stream. If you pump money into the money stream faster than it can dig a riverbed to contain it, then that money stream overflows its banks and the river floods on either side, and I think that creates inflationary pressures.

Likewise, if you want to create artificially high interest rates you just starve the economy for money, and you will get artificially high rates.

But what we have been trying to do here is to adapt this flow of money to produce the dual operation of encouraging the flow of capital for private domestic expansion where it is called for in this country and, at the same time, to minimize the outflow of capital abroad. And I want to reiterate here what has been the Federal Reserve Board's position and what I understand to be the position of those in the administration that I have consulted with on this also, that we do not intend to peg interest rates. At no time have we intended to peg interest rates.

Now I cannot forecast what the future is going to be. But, generally speaking, against this background, if business continues to rise—it may not continue to rise and I am not here forecasting it will—interest rates will tend also to rise.

We can, perhaps, moderate movements in rates, but we cannot control them. If business stays about where it is under present conditions, interest rates will stay about where they are. If business declines, interest rates will decline. That is the best I can do with the——

Senator BUSH. And, conversely, if business improves interest rates should rise; is that right?

Mr. MARTIN. Yes.

Senator BUSH. Yes. I do not want to be too persistent on this, but the President speaks, in spite of the recovery that he mentions, of the desirability, clearly desirable, it is clearly desirable, that some further downward adjustment in interest rates take place—this would not seem to me to fit in with the statement you have just made.

Mr. MARTIN. I think it depends entirely on what happens in the business picture, and I want to make my position on interest rates clear again, as I have many times. I have repeatedly stated that I would like to see as low interest rates as you can have without producing inflationary pressures.

But I do not think the Federal Reserve Board ought to be asked to force interest rates or to peg interest rates. It is self-defeating and does not help in putting unemployed back to work.

Senator BUSH. That is a very satisfactory answer to this question. I am very glad to hear you say that, and I certainly agree you have been consistent in this position over the years that you have been coming before these committees.

I have no other questions, Mr. Chairman.

Chairman PATMAN. I would like to pursue that for just a little, Mr. Martin.

I read this statement this morning to Mr. Hayes, and Mr. Hayes' answer was that, although the members of the Federal Open Market Committee are all aware of this statement, it has not been taken up. He said he was not speaking for the Open Market Committee, and I did not press him for what the Open Market Committee would probably do, because you were coming on this afternoon. Since you are the Chairman, I would like to ask you what you propose to do about this.

Will you ask the Open Market Committee to take into consideration this statement of the President's?

Mr. MARTIN. I will be very glad to see that every member of the Open Market Committee has a copy of the statement.

Chairman PATMAN. I know; it was delivered to the Congress. It was important enough that the President of the United States came before a joint session of Congress and delivered a message, the title of which was "Urgent National Needs," and among the urgent national needs he said:

> The full financial influence of Government must continue to be exerted in the direction of general credit ease and further monetary growth while the economy is recovering. Some further downward adjustment in interest rates, particularly those which have been slow to adjust in the recent recession, are clearly desirable, and certainly to increase them would choke off recovery.

That is the President of the United States speaking.

In other words, if I understand that correctly, he is saying to you and everyone else connected with monetary policy or monetary affairs to adjust your business so there will be some easing of interest rates.

Now, will the Federal Reserve respect that in any way—I mean the Open Market Committee of the Federal Reserve System—in an attempt to carry out his objective here?

Mr. MARTIN. The Federal Reserve will consider that, Mr. Patman, as I have answered Senator Bush here in the light of all of the circumstances.

The President followed that with an announcement of a reduction in FHA rates to 5¼ percent. That is well within his prerogative and his program and, of course, there is a difference between "clearly desirable" at a given time and what may actually develop or come about.

Now, I would like to see, and I reiterate, as low interest rates as we can have without producing inflationary pressures.

But, as I explained a moment ago, I do not want to see pegging develop and I do not want to see artificially low interest rates.

I want interest rates to be related to the flow of money into the economy. That is what interest rates are all about; they are an equilibrating factor.

Chairman PATMAN. Let me ask you this then: I understood from Mr. Rouse's testimony yesterday that your February 20 announcement was misunderstood, and that, in truth, the Open Market Committee has not make any decision to try to reduce long-term interest rates; is that correct?

Mr. MARTIN. Mr. Patman, I made a very full statement on that when I was up here on March 7, I think, in answer to a question that you put to me.

We have made a bona fide effort to endeavor to bring about a meaningful decline, although I pointed out how difficult it is to bring about a meaningful decline in long-term interest rates and, at the same time, to maintain the short rate in view of the balance of payments difficulty that we had. I pointed out at some length in the statement that I made on March 7 what the difficulties and problems were. And we have made a conscientious, sincere, earnest and continuing effort to carry out both the spirit and intention of that February 20 statement.

Chairman PATMAN. You mentioned balance of payments. Of course, that refers to gold, and, of course, we know how much gold we have and we know how much the countries have, not beyond the Iron Curtain. Do you know how much gold Russia has or do you have any idea?

Mr. MARTIN. I have never been able to find anybody who has an estimate that I would consider——

Chairman PATMAN. Do you know anything about their potential gold-producing capacity?

Mr. MARTIN. No, I do not, although I have been over to Yakutsk, and I have seen one or two of their mines. That is completely gratuitous; but I would say that they certainly have an excess of $4 billion. That is as far as I would want to go.

Chairman PATMAN. In excess of $4 billion?

Mr. MARTIN. $4 billion.

Chairman PATMAN. Do you know how much Red China has?

Mr. MARTIN. I have no idea how much Red China has.

Chairman PATMAN. Do you have any idea of her potential gold-producing capacity, what it might be?

Mr. MARTIN. No, I could not give you a comment on that.

Chairman PATMAN. Well, have you considered this, that we could be, in effect, supporting the countries of Communist Russia and Red China by accepting their gold, if not directly, indirectly, and not knowing how much they have or what their capacity for production is. It just occurs to me that we should give great consideration to that, because they are trading their gold to us for the very finest equipment, of course indirectly, that we are capable of making; and to an extent we could be supporting the Communist countries; don't you think so?

Mr. MARTIN. No, I do not, Mr. Patman. When they sell us gold, I think it is to our advantage to purchase it.

Chairman PATMAN. Well, what is the advantage? Now, we take something that is useless to us, it does not help us in our domestic economy, we put it over in the hills of Kentucky and leave it there; in other words, we are trading them something that is worth while, that is good for any nation, and helpful to any nation, and very valuable, durable goods, things like that, for something we do not use at all, and really do not need.

Mr. MARTIN. Well, that is where we—I think that gold, which is the basis of not only our currency but in terms of relative relationships of values to the currencies of every country on the face of the globe, whether they are on a gold bullion standard or not, is still the prime reserve asset of the world, and that it is not a worthless metal. You can, true you can——

Chairman PATMAN. I did not say it was worthless. I said it was worthless as far as our use is concerned. We do not use it. It is not even good to pay debts.

Mr. MARTIN. Well, it adds to our money stock, and it is certainly a reserve which we can use, and we can sell it in other places of the world if need be.

People have discussed this subject ad infinitum for many, many years, but the fact remains that the world still looks to gold as a standard.

Chairman PATMAN. I would like to invite your attention to something I think is going on here in the United States of America right now that is a very dangerous trend. In fact, I have never voted for Federal aid to education because I felt like it is a matter that the local communities should handle and control. But this time I am not so sure, and here is what I base it on as it is directly connected with the banking system.

In 1921, 40 years ago, we had 30,000 banks in this country. Today we have fewer than 14,000.

Now, ordinarily, you would think that as the country was growing, expanding, you would expand the number of commercial banks. But instead of that they have been reduced and, consequently, the availability of local credit has been tighter and tighter all the time, and local banks are going out of the business of making local loans so much, and investing more in U.S. Government securities, and even in

tax-exempt municipal securities now, getting away from the local help that the local bank, I think, is supposed to give.

Here is the answer I give people who write me about being against Federal aid to education: If the people had the moneymaking opportunity they used to have in their local communities, and they could take care of their local needs, like education, and their aged people and welfare programs that would be fine; that would be much better.

But now the local business opportunities are gone, and absentee ownership has taken over Main Street all over America. I do not know a single city of any size whose Main Street is not taken over by absentee owners, and that has reduced the opportunities of local people to go into business and earn money and keep it there. In other words, local people in times gone by, in acquiring local profits, they would put the money in the local bank, and it would be a basis for expansion of 10 to 1 or more, depending upon the class of the bank, of course, and would help everybody in the community.

But now that money flies to New York nearly every night—I do not mean it in the sense that I am opposed to New York or anything like that—it flies to a distant city or goes to another place, and the local people are denied the use of that money. That is what you might call the seed-corn money.

So with the local people not being able to make money like they used to, and then these bond issues they float for school improvements and education, the tax rate has become almost prohibitive, and I believe they have assumed just about as much of a burden as they can locally. Take into consideration, too, the fact that in all these school districts a large percentage of the people pay taxes on all that the tax assessor can see, visible, tangible property, improved lands.

Most of this land is in the way of homes; in the case of veterans, sometimes 90 percent of it is owned by somebody else, at least the mortgage up to 90 percent, and people who own their farms and plantations and everything, owe on them.

Now, they are paying taxes on what they owe as well as on what they own, in order to support these bond issues for the purpose of providing school facilities and schoolteachers and so forth.

Now, that is going just about as far as I think it can go, and the people just cannot pay much more in local taxes because it is becoming too burdensome. I am asking myself the question where are they going to get that money? They just cannot do it if you add more taxes. The State will eventually own the land if you add more taxes, and that will be socialism with a vengeance, really, because it will be forced sales to take the people's land. If we have to double the appropriations for education in the next 10 years, as our experts tell us, and if you have to double the taxation on this real property and school districts in the next 10 years, the State will own all the land, no question about it. They just cannot go any further.

So it occurs to me that there is a growing reason there to consider the Federal Government's coming in.

Now, the monetary authorities come in on this because they have permitted the bankers to restrict the number of banks down through the years, and by restricting the banks, of course, it did not take so much business to make them profitable. They did not have to depend too much on the local business—they could go outside and they could

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pick out their class of risk and the type business they wanted to do, and let the little businessman and the small farmers go. I think the banking community and the monetary authorities, particularly, are to be blamed for some of this.

I think the bank examiners have contributed to it greatly because they have encouraged the local banks to stay out of local paper, get into something else, and I think that the banking system or the banking community and the banking authorities are making a great mistake there in permitting fewer banks, and restricting local credit.

I have a feeling that if something is not done, our community spirit is going to be almost destroyed; it is deteriorating all the time, because of the lack of opportunity locally for people to make money and go into business.

They begin to think about their boys and girls. What chance will they have in the future? Will they just be hired hands and clerks? Will they have to work for somebody else? If they want to go into business where will they get their money? Who will they be in competition with? Have you given consideration to that problem, Mr. Martin?

Mr. MARTIN. Mr. Patman, as I have indicated before, I favor the maximum number of unit banks that we can maintain around the country. I think that is very——

Chairman PATMAN. You are against the branch banking system and the holding company system?

Mr. MARTIN. Holding companies are regulated by the Congress under an act which you had a part in passing in 1956, which the Federal Reserve now administers, and bank mergers we deal with under the 1960 bank merger legislation; and we make reports on both of those to you in our annual reports.

Chairman PATMAN. Yes. My time has expired.

Senator Proxmire.

Senator PROXMIRE. Governor Martin, is this your chart? I am informed this is Congressman Reuss' chart. I am sure it is just as accurate as if it were a Federal Reserve chart.

Representative REUSS. The lower half is the Federal Reserve, and the upper half is the Department of Labor.

Senator PROXMIRE. This chart indicates to me that the seasonally adjusted unemployment rate and the most recent figure would push it just as high as it is now for May, it was just out a day or two ago, indicates unemployment is as high now, seasonally adjusted, at 7 percent as it has been really in the last 20 years, as high as it has been since before World War II with, perhaps, an exception during the depth of the recession in 1958.

Now, in view of this situation, and in view of the fact that I think you properly indicated to Senator Bush that you had reservations about forecasting the future, and you would like to base your policy of what you can see with the evidence, doesn't this statistic indicate that the conditions of the present time suggest that we should continue to have monetary ease?

Mr. MARTIN. That is what we have, Senator, that is exactly what we have.

Senator PROXMIRE. Well, the statistics that I have in front of me given to us this morning suggest that the interest rates are about the same now, they have gone down some, but they have not gone down very sharply over the past several months, the past 6 or 8 or 10 months.

Mr. MARTIN. Well, these just do not coast down and coast up. May I again return to my flow of money illustration.

We have endeavored to make this period of easy money as effective and as productive as we could make it. It has been in effect now, this policy, for over a year, and there has been a turnaround in the reserve picture of $1 billion, from minus $500 million to plus $500 million in a year. That is a very dramatic turnaround.

Now, there is a question of whether you are reaching the point where you are not helping the unemployed or anyone else by just slopping in more money. I am not suggesting any tightening of money today; I am just suggesting that, given the forces in the economy, the Federal Reserve Board is trying to provide an appropriate level of reserves for use in our markets for goods, manpower, and services. I believe it is a mistake to think that interest policy alone will cure unemployment.

Senator PROXMIRE. Well now, let us just take the statistics on the basis of what we have. What action has the Federal Reserve Board taken to increase the money supply? Let us take them one by one. In the first place, take the open market operations. I have in front of me the total securities held by the Federal Reserve banks January 1, 1960, $26,648 million; May 24, 1961, $26,747 million, about the same, a slight, very moderate——

Mr. MARTIN. You forget reduction in reserve requirements that occurred, a very substantial reduction in reserve requirements that occurred——

Senator PROXMIRE. I will come to that after we discuss open market operation. You would agree there has not been any significant easing in the last year and a half?

Mr. MARTIN. There has been a very significant easing in terms of reserves from minus $500 million to plus $500 million. That is $1 billion.

Senator PROXMIRE. If you will bear with me, Governor, I want to take up the rediscount rate and the reserve requirements in turn. But first I want to discuss open market operations. As I understand it, one way of increasing the money supply is for the Federal Reserve to buy Government obligations, and there is no indication in the portfolio, as I read it, that would suggest that this has been used significantly to expand the money supply over the last year and a half—fluctuation but no substantial difference.

Mr. MARTIN. From the week ended May 31, 1961, over the week ended June 1, 1960, the increases have been $858 million.

Senator PROXMIRE. Well, all right. That is an increase of $858 million in the past year. But that again, from a point at which the Federal Reserve had previously decreased from $27,300 million down to on January 1, 1961, down to this point that you mentioned—it depends on what indicator you take here. I should say the beginning point.

Mr. MARTIN. Well, we have very difficult seasonal movements to which we have to try to adapt these operations—always to adjust to Easter and Christmas; those dates come into that picture, and we have to use open market operations to adjust to them. It is the finest instrument we have.

Senator PROXMIRE. Fine.

You have an increase then of about, would you say, less than 4 percent, about a 3-percent increase then of the portfolio, of about 3 or 4 percent.

Mr. MARTIN. Yes.

Senator PROXMIRE. This is at a time when the gross national product was increasing about the same?

Mr. MARTIN. The gross national product has been going down for this period.

Senator PROXMIRE. Well, it went down, it is fluctuating, it went down during the fourth quarter of the year, but you took the end of the second quarter. We can come back to that.

Mr. MARTIN. There is very little change in that period, Senator.

Senator PROXMIRE. All right.

How about the rediscount rate?

Mr. MARTIN. The rediscount rate was reduced, I believe—I will have to refresh my memory—it was June, early June, last year, a year ago.

Senator PROXMIRE. What is the present level?

Mr. MARTIN. It was then 4 percent and was reduced in early June 1960 to 3½ percent. It was further reduced to 3 percent in August 1960. It has been retained at that level since.

Senator PROXMIRE. Three percent?

Mr. MARTIN. That is right.

Senator PROXMIRE. All right.

Then the other is reserve requirements. How much has that been increased? I think the best way to put this in proportion is if you have the statistics, they may not be readily available, the increase in bank reserves, what proportionate increases have there been as a result of a reduction in reserve requirements?

Mr. MARTIN. Including vault cash releases, about $2 billion.

Senator PROXMIRE. Give me a rough estimate.

Mr. MARTIN. About $2 billion.

Senator PROXMIRE. What does that represent in proportion to the total bank reserves, how much of it in relation to the reserves?

Mr. MARTIN. I would say a little less than 10 percent.

Senator PROXMIRE. A little less than 10 percent.

Now, we start from a position a year ago when we had about the tightest relationship between the money supply and the gross national product that we have had in a long time, and I think you have to go back almost to the period of the middle twenties, and I hope you will correct me if I am wrong, when we had a lower ratio of money supply to gross national product, is this correct, and if not, can you tell me where we had a lower ratio?

Mr. MARTIN. No, I think that is correct. But I think that policy was called for, and was very desirable.

Senator PROXMIRE. It may be. What I am trying to establish is whether or not it is a true statement that we are now in a position of credit ease?

Mr. MARTIN. What?

Senator PROXMIRE. How can you say we are in a position of credit ease when we have moved so slightly or modestly. We have had a 10-percent increase in reserves, a 4-percent increase in the Federal security obligations of the Open Market Committee, and a very modest reduction in the rediscount rates compared to what it has been in

previous conditions of credit ease when it has been down to less than 2 percent. How can you say then we are in a position of credit ease today?

Mr. MARTIN. Well, for one thing, I can tell you that practically nobody is coming to the Board complaining about lack of money; that is surely one indication, though it does not prove very much.

But let me say to you that when you have a turnaround from minus $500 million in reserves to plus $500 million or $1 billion turnaround in the period of a year, you have had a very substantial easing operation.

Now, we go back to the 1957–58 period, when we reduced the discount rate, when we were not faced with the balance-of-payments problem, and we got the bill rate down to five-eighths of 1 percent very promptly, and the money supply for a short time in early 1958 was going up at the rate of 8, 9 percent per anuum; we were working effectively there.

Let me point out one of my favorite themes here, that the only thing in the 1957–58 recession that I can see went down was interest rates; unemployment rose and wages rose, the prices of products rose, and the demand for products receded. But the only thing that really went down and acted as a stabilizing factor was the level-of-interest rates. That decline was in response to credit policy, and credit policy worked very effectively there.

Now, what we are working against here, and to me this is the most difficult part of the problem, is that we have been in a period of inflation since the end of the war, and this has cumulatively become embedded in the consciousness of our people. This makes it more difficult to sell fixed income securities, and encourages people to go into growth equities on the stock exchanges and other places, because they say regardless of what you can say about any particular 3-month period since the end of the war, the fact of the matter today is that the U.S. dollar is roughly 65 cents of the early postwar dollar.

Senator PROXMIRE. Yes. But, Governor Martin, the point is interest rates have gone down slightly. The fact is they were extremely high, in the first place. In the second place. you talk about inflation. The fact is we have had a stable price level over the last several months, at least, and a very modest increase over the last year or so. In the third place and, perhaps, most important of all, the reason the price level has gone up is because we have certain rigidities in the economy, particularly in the labor union negotiation, and in the very powerful force of certain industries that are able to push their prices up regardless of the supply-and-demand situation. So you have a situation in which we have a deficit of demand with this vast number of people unemployed, with great factory capacity idle, and under the circumstances you say we are following a position of credit ease.

Surely we are, as compared with what we had immediately before. But in terms of our historical relationship of money supply to gross national product, this is not a position of credit ease at all. In view of the vacant capacity and idle resources in the country, in the economy, we can make an awfully good case for far more credit ease than we have now.

Mr. MARTIN. Well, that is a matter of judgment, Senator, and I do not quarrel at all with your judgment on that.

I merely point out that the whole world today is seeking savings and capital, and—I do not want to say what the right level-of-interest rates is—the problem that we have been dealing with is this worldwide inflation since the end of the war. And, in this country particularly, we have had inflation get ahead of us periodically and bring about recession, which none of us likes, in large measure because more and more people get the idea they can pass on increased prices of their product to the consumer, until finally we get a period of overcapacity and underutilization of resources. I do not think you can correct the underemployment or the overcapacity that comes about from this just by spending money and, particularly, by creating artificially cheap money.

Now, I still would like to see—and I reiterate this—interest rates as low as we can have them. But I do not want them artificially lower.

If you take all the industrial countries of the world today—and again I am not trying to argue by comparison—you will find that the United States has relatively low interest rates in the world spectrum, and this at a time when people are seeking capital, so that we have a competitive problem here to deal with.

Senator PROXMIRE. Thank you, Mr. Chairman. My time is up.

Chairman PATMAN. Senator Pell.

Senator PELL. I have no questions, Mr. Chairman.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Mr. Chairman, I am very much concerned as we all are, Governor Martin, at the fact that our unemployment rate continues at close to 7 percent, despite some modest signs of recovery, and I have a theory about what is wrong. I would like to put this to you and get your comment.

I have had a chart prepared here which shows the rate of unemployment, seasonally adjusted. This is the Department of Labor table which appears in the Economic Indicators every month, and I am sure you are familiar with the lower chart, which is your own Federal Reserve chart of net-free reserves and net-borrowed reserves.

As you just said, in answer to a question put by Senator Proxmire, at various times in the past you have changed the bank reserve position from a net-borrowed position of half a billion dollars to a net-free position of a half billion dollars, a total trip of $1 billion worth.

Now, let me call your attention to what seems to have happened in recent years. Let us start with 1954, when there was a recession, and unemployment was a rate of 6 percent, and the Federal Reserve, very properly, was creating free reserves of around half a billion, although they came to slightly higher in parts of the year.

Then, early in 1956, while unemployment was still high for those days, hovering at around 4 percent, the Federal Reserve tightened up on reserves and, as this chart shows, hastily produced a condition systemwide of net-borrowed reserves on the order of half a billion dollars, and this situation, where the banking system had no free reserves, but instead was in hock to the Federal Reserve in the order of a half a billion persisted for all of the second half of 1955 and for all of 1956 and 1957, during which entire period the unemployment rate did not improve at all, it did not go down toward the ideal that some of us hold of 3 percent, but stayed around 4 percent.

Then, in 1958, along came the recession of 1958, and then the Federal Reserve did loosen its reserves, eased credit, and gave the banking system some net-free reserves.

Then things started to get a little better, but before they really got much better, in the fall of 1958 credit was dramatically tightened, and as of the end of 1958, and persisting throughout 1959, once again the banks had no net-free reserves, but instead had net-borrowed reserves of around half a billion dollars.

Meanwhile, the unemployment rate hovered at around 5 percent, a percentage higher than the preceding plateau of unemployment.

Shortly this gave way to another recession, the 1960–61 recession, where the rate of unemployment went up to approximately 7 percent, where it now is. and that saw a release again of net-free reserves on the order of half a billion.

Now, what I am suggesting, Governor, is that the overtightening of credit by the Federal Reserve has contributed to the fact that we have had two recessions in the last 3 years, and that the level of unemployment, every time it stabilizes out in a nonrecession period, tends to be higher.

It was at 4 percent back in 1956; it was at 5 percent back in 1959. I trust that the Federal Reserve is not going to stabilize unemployment at 6 percent when we get out of the current recession, it having stabilized it at 4 percent in 1955 and 1956; at 5 percent in 1959.

Lest it be thought that what I am saying is a partisan point of view, I would like to call your attention to some recent statements made by some of the chief economic advisers of the preceding administration, the Eisenhower administration.

Mr. W. Allen Wallis, dean of the Graduate School of Business at the University of Chicago, in a speech he made in Milwaukee, Wis., last month, said that the Federal Reserve Board tightened up the money supply in 1959 "overvigorously and overpromptly as a move against inflation." But "the inflation wasn't there," according to Mr. Wallis.

Mr. Wallis, you remember, was Vice Chairman of President Eisenhower's Cabinet Committee on Price Stability for Economic Growth.

Then Mr. Arthur Burns, who was Chairman of the Council of Economic Advisers under the Eisenhower administration, in a statement put into the Record by our colleague, the gentleman from Missouri, Mr. Curtis, a few weeks ago, on April 27, said that many factors undoubtedly contributed to the unsatisfactory character of the business cycle expansion from 1958 to 1960, but three of them were preeminent and, as his second cause he cites the fact that the Federal Reserve pushed its credit tightening with undue vigor.

He says that by mid-1959 commercial banks were already indebted to the Federal Reserve to the tune of $1 billion; the money supply stopped growing, interest rates rose sharply, both on short-term and long-term loans. Indeed, long-term rates advanced faster than during a comparable stage of any business cycle during the past 100 years.

Well, enough to illustrate my theory that the Federal Reserve has been pulling in reserves from the banking system much too fast; that this excessive bringing of bank reserves into a net-borrowed position with the Federal Reserve has led to successively higher plateaus of unemployment, and that it has contributed to the 1958 and 1960

recessions. If this analysis is right of the past, I would like to express the hope that the Federal Reserve from here on out will keep its free net reserves in the banking system at something like the present level of half a billion until we get the unemployment rate down, not to 6 percent, not to 5 percent, but to some lower percentage, call it 4, if you like, which will enable the economy to grow, and us to make a dent in unemployment.

Thank you for your patience. I would like to now have your comments.

Mr. MARTIN. Well, I appreciate your comments, Mr. Reuss, and I want to say that the Federal Reserve deplores the unemployment situation just as much as you do, and is just as anxious as you are to lower it.

I cannot forecast what the future policy of the Open Market Committee will be, but I will certainly bear in mind your comments, and I am sure that all the members of the Open Market Committee will be very glad to have your observations.

I want to say about unemployment generally, that it is—I do not want to make a lengthy speech now, but I want to say it is—a puzzling operation.

If you take the 1953 low point on unemployment it was 2.6.

If you take the next low point in 1957 it was 3.9. If you take the low point in 1960—this last one—it starts at 4.8. I am taking the lows now, you mentioned some high, I think, and I am saying it is over that range.

But don't forget we were coming out of the wartime period, and I still want to reemphasize the fact that the dollar, from January 1, 1946—and this is a part of the psychological picture against which we are working, and has something to do with getting people back to work—is now roughly 65 cents from January 1, 1946, to date, and that is nothing that is going to encourage people to save money or to invest.

Representative REUSS. I wanted to leave out the war periods, both World War II and Korea, and so I started this in 1954, although——

Mr. MARTIN. But you cannot rule them out, that is my point.

Representative REUSS. Will you then produce a chart which includes any period you like, and if you can dispute my thesis that excessive withdrawal of reserves by the Federal Reserve has caused a stagnating level of unemployment and two recessions, I certainly would like to be made aware of it.

I point out that the decline in the value of the dollar, that is, the inflation, occurred very largely prior to 1954, so that the question I put to you and to your associates is, how long are we going to let the inflation which occurred in the period 1946 to 1954 cause us to draw in our reserves in the banking system at a higher level of unemployment each time there is a little breather from the last recession? That seems to me the question of policy which we should be thinking about.

Mr. MARTIN. I cannot forecast what the Open Market Committee will do, but I would be very glad to have your injunction.

Representative REUSS. Let me say, for my part, will you do this for me any time that the Open Market Committee, in its wisdom, in the days and months to come, decides that it is going to bring net free reserves of the banking system markedly lower than they are at pres-

ent, before the unemployment rate, seasonally adjusted, gets down to 4 percent, will you make it a point to inform the members of the Joint Economic Committee quite promptly of that?

I would regard a repetition of what has happened in the past as something that we would want to discuss then and there pursuant to our duties under the Unemployment Act of 1946 with respect to maximum production, employment, and purchasing power.

Is that not a reasonable request?

Mr. MARTIN. I could not do that on my own. That would have to be a committee action, as it involves how we report to the Congress with respect to our activities, and what we are concerned with here, of course, is responsibility and protecting the public interest. I could not come and tell you on my own; and it involves what could be told, for example, without telling the country, what we were doing in our operations, because this is the whole concept of markets. So what we have to do on all of these things is to put them into historical perspective. We can always put out charts, but we have to be concerned at all times as to whether we are being responsible in what we are disclosing and whether it is in the public interest. And, of course, I am only one man in this.

Representative REUSS. All right, then I ask you to do this: All the committee is screened for top secret clearance, and we can keep secrets. Will you inform the committee——

Mr. MARTIN. If the chairman of your committee—

Representative REUSS. Please let me finish. Will you inform the committee if at any time before the unemployment rate, seasonally adjusted, gets down to 4 percent, you have taken action to decrease net free reserves markedly beyond the present level of half a billion dollars? There is no great secret here. These are figures that you constantly keep, but I think it would be useful for the committee to discuss it with you.

Mr. MARTIN. You get them every Thursday. Every Thursday our weekly statement shows what the level of reserves is. That is a public statement.

Representative REUSS. Then you certainly are not going to be disclosing any great state secrets to us when you formally inform us of the fact that despite the existence of an unemployment rate of more than 4 percent, whatever it may be, 5 percent, 6 percent, 7 percent, you are taking action to do the very thing which, if I am right, caused stagnation and unemployment in two recessions, we would like to know and have a chance to talk to you about it.

Mr. MARTIN. Well, every Thursday our statement will be out and available; and if, for example, the chairman of your committee would ask me to send to each member of the committee a copy of that statement I will be very glad to do so. I think that many of you probably get it now as soon as it is available.

I cannot let this pass, however, without saying that I think you are wrong in your judgment about the relationship of monetary policy to unemployment. That is just one——

Representative REUSS. That is why I brought it up. I would like to have you tell me why I am wrong.

Mr. MARTIN. I think it is just one of the factors in the unemployment picture.

As I have tried to spell out on a number of occasions, I think this wage-price spiral, the productivity problem, and the consumer price problem—consumers are the forgotten men today in many respects—are all important factors. I would like to see if we can create additional demands, get new products, and put people back to work on something other than just a temporary basis; I think we have got to have much more than easy money to do it; easy money is just one of the needed factors.

But I am absolutely convinced that, in the overall picture, artificially cheap money does not contribute to reducing the unemployment picture.

Now, you say to me——

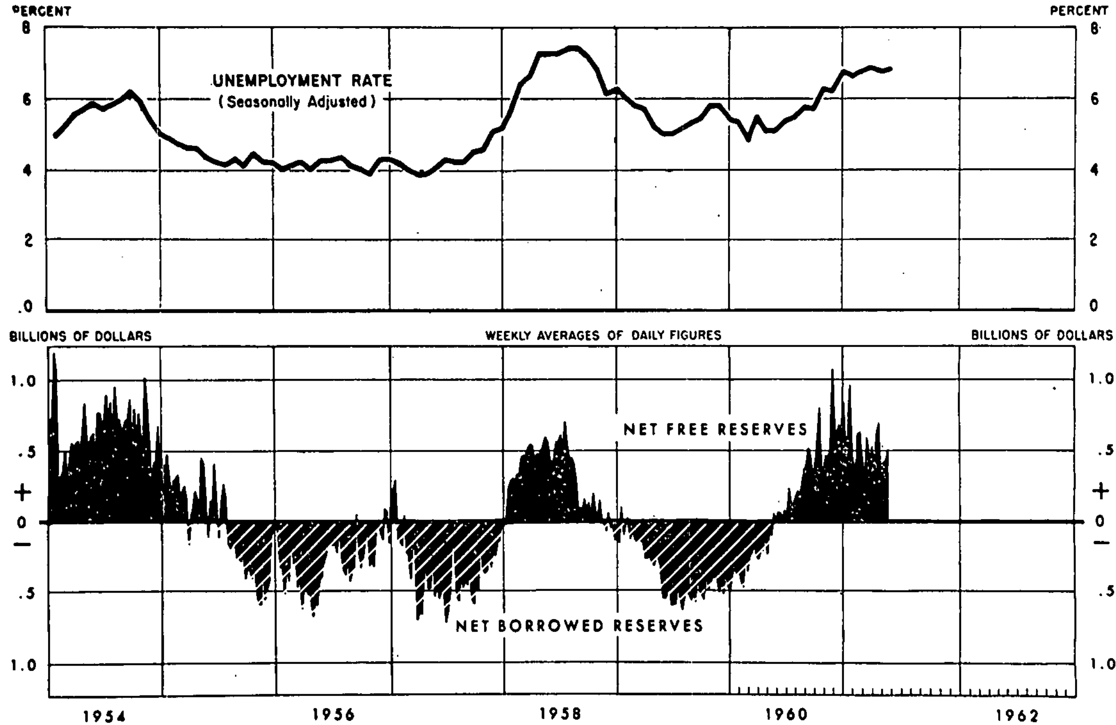
Representative REUSS. I am not for artificially cheap money, but just for the kind of money you are now producing, and should keep on producing until unemployment gets down to a manageable level, but I see my time is up, Mr. Chairman.

I would like to offer this exhibit for the record.

Chairman PATMAN. Without objection, it is so ordered.

(The document referred to follows:)

UNEMPLOYMENT RATE AND NET RESERVES OF MEMBER BANKS



Chairman PATMAN. Senator Bush?

Senator BUSH. Mr. Chairman, I would just like to ask this simple question. I want to be sure I get my dates right here, Mr. Chairman. Here you have a period of relatively good employment, around 4 million, 4 percent unemployed, which is relatively good, to the time when it is up around 7 percent, and while we have a period of relative good employment, the banks are active, and they are drawing on the Federal Reserve for credit; is that right?

Mr. MARTIN. That is right.

Senator BUSH. Now, the thing that seems to me to be the case is, it is the result of this that we have these figures, rather than the other way. Do you think there is anything in that argument?

Mr. MARTIN. I do indeed.

Senator BUSH. That is all I am interested in.

Chairman PATMAN. Anything else?

Senator BUSH. I am through.

Chairman PATMAN. Mr. Martin, we were asking Mr. Hayes some questions this morning about how these policy statements of the Federal Open Market Committee were interpreted, and I will ask you, you take, for instance, the statement by the Open Market Committee on March 1, 1960, where it said:

* * * "the directive that had been in effect since May 26, 1959, calling for operations with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities" was changed to read "to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion."

How do you expect the manager of the account in New York to take this statement alone and interpret it—just from this statement, that is? Would you expect him to do?

Mr. MARTIN. Yes, I would, if he is the competent man I think he is; I think that that gives him adequate information.

Chairman PATMAN. Well, of course, he testified that he had written notes himself at the meeting of the Federal Open Market Committee when this was agreed upon, and he used those notes.

Mr. MARTIN. Well we have had him participate in the meetings of the Committee because I think that is helpful to him.

Chairman PATMAN. Yes sir; I am sure it is.

Mr. MARTIN. But I am sure, as a specialist in this field, that this language means something to him.

Chairman PATMAN. But an outsider could not take this language and interpret it without that, could he?

Mr. MARTIN. Well, it is not that—outsiders are not the ones who are concerned with that particular point, and I think you are dealing here with the specialist, and it is very difficult to write——

Chairman PATMAN. Maybe I should not have used the word "outsider," but if he had not had other information than just the directive itself, it would be difficult of interpretation, would it not?

Mr. MARTIN. If he took over in a vacuum, yes.

Chairman PATMAN. That is right. In other words, if a stranger came in and took charge of the desk, he would have difficulty interpreting this—if that was all the information he had, the language itself.

Mr. MARTIN. Standing on its own, yes. But I think that it is a——

Chairman PATMAN. Therefore, he is necessarily dependent upon his notes that he made at the meeting partly, and also doesn't he have the benefit and advantage of the minutes made for the Federal Open Market Committee at the meeting?

Mr. MARTIN. Well, we have minutes of these meetings, Mr. Patman.

Chairman PATMAN. That is what I mean, and you make those minutes, one of the purposes being to give it to the manager of your accounts so as to help him in interpreting what you mean by this language, is it not?

Mr. MARTIN. Not only the manager of the account, but every member of the Committee.

Chairman PATMAN. I know, but he is the one who carries it into execution, as I understand it, and he is the person who actually takes action, and he is the only one who actually takes action, isn't that right?

Mr. MARTIN. Well, we are working constantly to get a directive which is more informative to outsiders as well as to our people involved in this, but I can assure you that the language is——

Chairman PATMAN. That is the point I am getting, Mr. Martin. I have considered this language, I have read these directives you have gotten up, and I am not expected to be able to interpret them myself, but I do not see how the ordinary, average person could possibly interpret what the language means. It is really, and I say this respectfully, it is gobbledygook. You just cannot tell what it is, and I do not believe you could tell if you just had this alone unless you had also the minutes of Federal Reserve Open Market Committee.

Mr. MARTIN. Well, we will certainly try to improve on any gobbledygook we have.

Chairman PATMAN. I am sincere about that. I have read them, and the testimony here seems to be very plain that you have a language in the street or in the financial community or in the Federal Reserve that means a lot to the Federal Reserve. You understand it only after attending the meeting of the Federal Reserve Open Market Committee and making your own notes and having the minutes of the meeting.

The traders, sophisticated people, the dealers, immediately, when you go into action on this, know exactly what you are doing, and they can profit from it, as they should, because of their knowledge. But people generally do not understand it, and cannot participate in anything that is done that would be helpful by reason of this directive.

The point is, don't you think that language should be plain enough for anybody to understand, and not restricted to people who are specialists in the market?

Mr. MARTIN. Well, I always like to see plain language, and we are glad to get suggestions—that is one of the benefits of this hearing—I would like to see the language as clear as it can be.

So far as it meaning more to sophisticates or to those who are experts than it does to a farmer, let us say, in Nebraska, I think that also applies to anybody who reads the baseball box scores or about anything else.

Chairman PATMAN. That is quite different, Mr. Martin.

Mr. MARTIN. A man absorbed in baseball can get more out of the box score than somebody who is not.

Chairman PATMAN. Well, one voluntarily goes into a sport. You are in this, whether you want to be or not. This affects everybody.

Mr. MARTIN. All right. I asked for it.

Chairman PATMAN. You could understand this a lot better if you had those minutes, couldn't you, of the Federal Reserve Open Market Committee?

Mr. MARTIN. You mean the general public?

Chairman PATMAN. This committee, for instance, we can understand it better if we had your minutes, the Open Market Committee minutes. Where are those minutes, Mr. Martin?

Mr. MARTIN. Those minutes are in the custody of the Open Market Committee.

Chairman PATMAN. Are you willing to give us the minutes for last year, 1960, so that we can use them in connection with these directives and see whether or not we can suggest improvements on the language?

Mr. MARTIN. Well, Mr. Patman, if your committee, if you want to write me and request those, I will put it before the Open Market Committee, and I will certainly do it in the most sympathetic way. I want to—and I have no—I have never withheld anything from you, as you know.

Chairman PATMAN. No, sir; you have been——

Mr. MARTIN. I have rolled up 5 years of audits——

Chairman PATMAN. You have been very good, but I see no reason for having to write you any letter, Mr. Martin; I am asking you here and now to let us have the minutes for 1960.

Mr. MARTIN. I think an orderly procedure—it is not that I in any way distrust you, Mr. Patman—but in the interest of orderly procedure, I will have to put this up to the Committee, because what we have here——

Chairman PATMAN. This transcript will be available.

Mr. MARTIN. It is in the public interest that——

Chairman PATMAN. I am asking you now to furnish us the minutes for 1960. That is long behind us, it certainly cannot be current information, and it could not be dangerous or harmful. I am asking you to furnish us the minutes for 1960. When can you let us know about that?

Mr. MARTIN. I cannot let you know about that until after the Open Market Committee meeting next week.

Chairman PATMAN. When does it meet?

Mr. MARTIN. It meets June 6.

Chairman PATMAN. June 6. All right, sir, I shall not press it until after June 6. Will you let me know then?

Mr. MARTIN. I will be glad to let you know.

Chairman PATMAN. All right, fine.

(On this point a letter from Chairman Patman to Chairman Martin and Chairman Martin's reply thereto follows:)

JUNE 14, 1961.

Hon. WILLIAM McC. MARTIN,
Chairman, Board of Governors, the Federal Reserve System,
Washington, D.C.

DEAR MR. MARTIN: The purpose of this letter is to make clear the requests made of you and Mr. Rouse, concerning records of considerations and decisions

of the Federal Open Market Committee, during the hearings of this committee on June 1 and 2. The records requested are of three types, as follows:

First, the verbatim record of the Open Market Committee meetings, or the full minutes of the Committee meetings, or both, if both verbatim records and minutes were made during the year 1960. (This request was made at p. 242 of the transcript of June 2.)

Second, all interpretative memoranda and all notes taken or prepared by Mr. Rouse or any other members of the staff of the Board of the New York Reserve Bank concerning the deliberations and policy decisions of the Open Market Committee, plus copies of the wires from the Board to Mr. Hays and Mr. Rouse (referred to by Mr. Rouse at p. 57 of the transcript for June 1). This request is also made for records pertaining to the calendar year 1960. (This request was made of Mr. Rouse at various pages of the transcript for June 1, especially at p. 77.)

Third, a description of all the factors which the Open Market Committee took into account on the last occasion when it instituted a policy of restraint, and a description of the factors which it took into account on the occasion of the immediately preceding meeting, prior to institution of a policy of restraint.

Sincerely yours,

WRIGHT PATMAN, *Chairman.*

BOARD OF GOVERNORS,
OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, June 21, 1961.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: The Federal Open Market Committee has carefully considered the requests for copies of its minutes and certain other materials for the year 1960, made of Mr. Rouse and me during the Joint Economic Committee hearings of June 1 and 2, 1961. You and I have discussed these requests by telephone, and they were referred to in your letter of June 14, 1961. It is the view of the Federal Open Market Committee that it should act as follows on your committee's requests:

1. A memorandum outlining the considerations taken into account on the last occasion when the committee instituted a policy of restraint is enclosed. In this connection, I should point out, as do the answers I have already submitted to the list of questions you raised at the hearings, that the determination of monetary policy is a continuous process, and thus it is difficult to pinpoint the moment of a change. To repeat a comment I made on this subject more than 5 years ago:

"Monetary policy * * * must be tailored to fit the shape of a future visible only in dim outline. Occasions are rare when the meaning of developing events is so clear that those who bear the responsibility can say, 'As of today, our policy should be changed from ease to restraint'—or from restraint to ease, as the case may be. What is true of a change in policy is also true of a shift in policy emphasis: it is rarely decided upon in a single day. More typically, as is evidenced by open market operations, the outline of a shift in policy emphasis, like the outline of the future, emerges gradually from a succession of market developments, and administrative decisions. It is a poor subject for the photoflash camera to capture as a clearly defined still life, or for a news story to etch in spectacular outline. Getting a perfect garment for the future may require several fittings."

Therefore, factors considered and analyses undertaken by the Committee during the meeting immediately preceding and during other meetings further back in time might not seem strikingly different from those at the meeting that may be selected as marking the beginning of a policy of restraint.

2. Copies of the wires referred to in your letter as being from the Board to Mr. Hays and Mr. Rouse are enclosed. These wires, prepared at the offices of the Board of Governors and sent to all Reserve bank presidents as well as board members, contain a detailed summary of the 11 a.m. daily conference call which, you will recall, was fully described by Mr. Rouse in his statement that he read at the hearing on June 1 and submitted for the record. Most of the information contained in each wire is a rundown of developments in the

money and securities markets during the first hour of trading that morning. The last part of the wire indicates what the account proposes to do that day, given the situation as seen at 11 a.m.

3. Regarding the notes and interpretative memoranda referred to in your letter:

(*a*) There is very little in the way of note taking beyond that done by the secretarial staff of the Committee and by a staff member of the New York bank to record what actually transpires at the meetings. Any notes taken at the meetings by Committee members are usually no more than scribbled abbreviations for the purpose of keeping for the moment a running memory aid of the discussion as it proceeds, and such notes are not customarily retained. The minutes are prepared promptly by the secretarial staff and drafts thereof are usually in the hands of the Committee members and Mr. Rouse, as manager of the System Open Market Account, within a week to 10 days. The secretary of the Committee also furnishes Mr. Rouse by the morning of the day following a meeting a brief unedited synopsis of each member's policy recommendations and of the consensus of the Committee. The notes taken by the staff member of the New York Reserve Bank are recast in the form of an internal memorandum for working purposes, and this memorandum and the synopsis are available to Mr. Rouse as an aide memoir pending receipt of the preliminary draft of minutes and the final minutes. Since these are merely staff working papers and their content is fully covered in the minutes, it seems needless to furnish them separately.

(*b*) As to interpretative memoranda, these may be taken to include the economic summary prepared by the Board's staff, projections of reserve figures and factors, and the detailed record of open market operations undertaken since the previous meeting, all of which are furnished to Committee members prior to the meeting. Copies of these are enclosed, although their substance is covered to some extent in the minutes.

Also, there is enclosed the pertinent opening paragraph of a memorandum dated August 2, 1960, and sent by Mr. Rouse to the members of the Federal Open Market Committee and the Federal Reserve bank presidents not then serving on the Committee, expressing his understanding of the consensus of the Committee at its July 6, 1960, meeting relative to possible open market operations in short-term securities in addition to Treasury bills. This is included because it might be considered to be interpretative of a Committee discussion.

4. Verbatim records of the meetings of the Federal Open Market Committee are not made. The minutes, however, present a faithful and comprehensive record of the Committee's proceedings. The Open Market Committee is prepared to make these minutes of its meetings held in 1960 available to the Joint Economic Committee on the understanding that they will be treated as confidential. It should be noted, however, that some members of the Committee feel that normally it might be more appropriate for a request for the minutes to come from the Banking and Currency Committee of the House or of the Senate. With regard to the request that the minutes be handled as confidential, the Committee believes that it would not be in the public interest to have such minutes for 1960 made public in whole or in part at this time, and its reasons for this position are as follows:

(*a*) There are references in the minutes to information obtained on a confidential basis. This information, and its sources, should be kept confidential, certainly for a substantial time period.

(*b*) From time to time there are references in the minutes to long-term prospects and possible monetary policy action should these eventuate. To guard against a reduction in the effectiveness of Committee actions or potential actions, there should be some considerable elapse of time before the minutes of any given meeting are given public access.

(*c*) The minutes contain a full account of the proceedings at the meetings, including the participants' statements. However, a person will frequently compress his remarks by omitting matters of background perspective that are fully understood by others present at the meeting, but which might lead to misinterpretation on the part of one merely reading the minutes without the advantage of having been present.

(*d*) The minutes contain statements by individual members which are often made to raise points of discussion or to probe the possibilities of different courses of action in implementing System policies. These statements do not necessarily represent a firm view of the individual member and, in fact, the member may

raise a particular matter merely to obtain discussion and clarification of the issues involved. Needless to say, individual views expressed early in a meeting may well be modified by subsequent discussion during the meeting. Therefore, the participants should feel to raise questions and express their views—either tentative or firm—with the knowledge that their comments will not be released within a short period of time after the meetings. This freedom of discussion and the exchanges of viewpoints prior to the final decision are essential features of the process of decisionmaking.

It is largely for the foregoing reasons that the Open Market Committee believes that the public interest would not be served if the minutes for 1960 were to become public documents at this time, either in whole or in part. The Committee is particularly of this view, in the light of the comprehensive record of policy actions made available some months ago in the 47th Annual Report of the Board of Governors of the Federal Reserve System.

The official records of the Federal Open Market Committee are maintained in the Board's offices, where the original copy of the minutes for 1960 is available for examination by representatives of your committee. However, with the thought that it would be more convenient, the duplicate original signed copy of the 1960 minutes is being delivered herewith to the custody of your committee for its perusal. It will be appreciated if this duplicate original is returned to us for safekeeping as soon as it has served its purpose.

Sincerely yours,

WM. McC. MARTIN, Jr.

Enclosure.

AUGUST 2, 1960.

To: Members of the Federal Open Market Committee and Federal Reserve bank presidents not presently serving on the Committee.
From: Robert G. Rouse.
Subject: Operations in short-term securities other than Treasury bills.

At the July 6 meeting of the Open Market Committee there was considerable discussion of the possibility that open market operations might, under certain circumstances, be conducted in other short-term securities in addition to Treasury bills. It was the understanding of the account manager that the consensus of the committee was that it was the Manager's responsibility to initiate operations in short-term securities other than bills if the general state of the market and the reserve situation suggest that such a course of action is desirable. If such an occasion should arise, the account management expects to state its intention at the time of the 11 o'clock call. This will allow members of the Committee an opportunity to register an objection, if they have one.

Mr. Boggs?

Representative BOGGS. I have no questions.

Chairman PATMAN. I have several statements here. I understand you want to get away. I do not want to take up too much time. I have some questions that I would like to file along with some explanatory statements and charts, and I will put them in the transcript and ask you to answer them when you correct your transcript, if you please.

Mr. MARTIN. I will be very glad to.

Chairman PATMAN. Without objection, I will put in this statement by Dr. John G. Gurley of the Brookings Institution; and a group of charts prepared by the staff, some of which were supplied by the Federal Reserve Board staff; and another statement by James W. Knowles, a member of this committee staff; one by Dr. Asher Achinstein of the Legislative Reference Service, and an article entitled "The Political Structure of the Federal Reserve System," by Michael D. Reagan, Princeton University.

71497—61——8

(The documents referred to follow:)

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

Memorandum
To: Wright Patman, chairman.
From: John G. Gurley.
Subject: Notes on the 1960 Report of the Board of Governors of the Federal Reserve System

By Dr. John Gurley of the Brookings Institution.

The Board of Governors and the Federal Open Market Committee study a wide range of economic indicators before coming to decisions on various aspects of monetary policy. Policy decisions concern the appropriate level of reserve requirements on member banks' demand and time deposits, whether the margin requirement on stock purchases should be altered, and whether approval should be given to changes in discount rates of the Federal Reserve banks. In addition, the Open Market Committee issues a policy directive to the Federal Reserve Bank of New York, which serves as a guide for the execution of open market operations in Government securities. Open market operations, along with the other policy decisions, affect economic activity, including the range of economic indicators studied by the Reserve officials. Consequently, changes in these indicators influence subsequent policy decisions and directives. The following discussion focuses on this circular process; the information furnished in the 1960 annual report is analyzed and a number of questions about actions taken and the results of these actions are raised.

POLICY DECISIONS AND DIRECTIVES AND ECONOMIC INDICATORS

The Board of Governors has the authority to alter the level of reserve requirements on demand and time deposits of member banks, to approve changes in discount rates of the 12 Federal Reserve banks, and is responsible for changing the margin requirement for purchasing and carrying registered stocks. The Federal Open Market Committee adopts policy directives, which are general instructions concerning open market operations in Government securities.

This Committee is the principal policymaking body of the Federal Reserve System. It is officially composed of the 7 members of the Board of Governors and 5 Federal Reserve bank presidents. The president of the Federal Reserve Bank of New York is always a member; the other 4 positions rotate among the other 11 bank presidents. The Open Market Committee meets every 3 weeks in Washington, at which time the Committee studies a wide range of economic indicators before deciding on the proper role of monetary policy in the period ahead. The instructions necessary to implement such a policy are embodied in a directive to the Federal Reserve Bank of New York, setting out the Committee's policy in broad terms, and this policy directive is translated into specific actions by the manager of the System account.

The Board is required by law to keep a record of the discussion, the votes, and the actions taken by the Open Market Committee. It is required to report annually to Congress, including an account of the actions taken by the Committee during the preceding year.

Policy Decisions and Directives

The Board of Governors twice approved reductions in discount rates of the Federal Reserve banks during 1960. The first reductions came during June, and the second during August and early Setpember.[1] Discount rates were 4 percent before June, lowered to 3½ percent at that time, and lowered once again to 3 percent in August-September.

The Board of Governors also reduced the margin requirement for the purchase and carrying of registered stocks, from 90 percent to 70 percent. This was effective on July 28.[2]

[1] Pp. 80–81, 85–86.
[2] Pp. 81–83.

The reserve requirement on time deposits was not altered during the year. However, the requirements on demand deposits were changed several times. For central Reserve city banks, the requirement was lowered on September 1 from 18 percent to 17½ percent, and reduced again to 16½ percent on December 1. For so-called country banks, the reserve requirement on demand deposits was raised from 11 percent to 12 percent, effective November 24. No change was made in the reserve requirements for Reserve city banks. In addition, effective November 24, member banks were permitted to count all of their currency and coin as part of their required reserves; only a fraction of such vault cash could be so counted before that date.[3]

The Federal Open Market Committee, as already noted, adopts a policy directive every 3 weeks, which guides the execution of transactions for the System open market account. At the beginning of 1960, the policy directive in force, first adopted in such form at the meeting on May 26, 1959, read as follows:

"(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) *to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities*, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

"(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve banks shall not exceed in the aggregate $500 million."[4]

Clause 1(b), which is italicized above, was altered several times during the year. It was revised at the meeting of March 1, "so as to provide that open market operations should be conducted with a view 'to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion.'"[5] This presumably placed more emphasis on growth of economic activity and less on guarding against excessive credit expansion.

The same clause was again revised at the meeting of May 24 to provide that open market operations should be conducted with a view "to fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion."[6] Thus, instead of guarding against excessive credit expansion, a moderate amount of such expansion was sought.

Clause 1(b) was revised for the third time on August 16 to provide that open market operations should be conducted with a view "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment." The Committee also added that "doubts arising in the conduct of open market operations should be resolved on the side of ease and that such operations should take into account, even more than usual, the tone of the market rather than statistical measures."[7] The Committee thus moved from a policy of moderate ease to one of active ease.

On October 25, the clause was revised for the final time to add the words: "while taking into consideration current international developments." In addition, the first paragraph of the directive was revised to raise the amount of increase or decrease in the aggregate amount of securities held in the System open market account to $1.5 billion from the customary $1 billion.[8] At the next

[3] Pp. 83–84, 87–88.
[4] Pp. 35. Italic supplied.
[5] Pp. 41–43.
[6] Pp. 54–55.
[7] Pp. 61–63.
[8] Pp. 67–70.

meeting, on November 22, the latitude for increasing or decreasing security holdings was restored to $1 billion.[9]

Table 1 contains a summary of directives adopted and actions taken:[10]

TABLE 1.—*Policy and directives and actions*

Month	Open market operations	Reserves and reserve requirements	Other actions
January			
February			
March	Placed less emphasis on restraining inflationary credit expansion.		
April			
May	Placed more emphasis on providing reserves for moderate bank credit expansion.		
June			Lowered discount rates from 4 to 3½ percent.
July			Lowered margin requirement from 90 to 70 percent.
August	Encouraged monetary expansion.	Permitted member banks to count more vault cash as required reserves.	Lowered discount rates from 3½ to 3 percent.
September		Lowered reserve requirement on demand deposits for central reserve city banks from 18 to 17½ percent.	
October	Took into consideration current international developments.		
November		Permitted member banks to count all vault cash as required reserves; raised reserve requirement on demand deposits for country banks from 11 to 12 percent.	
December		Lowered reserve requirement on demand deposits for central reserve city banks from 17½ to 16½ percent.	

Questions may be raised about certain aspects of the meetings of the Federal Open Market Committee. These questions are grouped under three headings: (*a*) the organization of the Committee meetings; (*b*) the published reports and summaries of these meetings, and (*c*) the meaning of certain phrases and statements in the policy directives.

A. Organization of meetings

1. Are transcripts taken of the meetings?
2. In what way is the agenda of the meeting determined?
3. Is there participation at the meetings of the regional bank presidents who are not currently members of the Committee?
4. Do the staffs of the Board of Governors and of the regional banks participate in the meetings?

B. Published summaries of meetings

1. When are the summaries of the meetings prepared?
2. Do all Committee members see and approve the minutes and summaries of the meetings?
3. Why does the Board delay publication of the summaries of the meetings for periods of from 4 to 16 months? Would it not be better for the "market" to know fairly soon the policies of the Committee, rather than left to its own speculations about such policies?

[9] Pp. 72.
[10] A digest of such actions appear on pp. 4, 5.

C. Meaning of policy directives

1. It is not clear from the policy directive what the Federal Reserve is attempting to control. At times, clause 1(b) of the directive refers to "credit expansion;" at other times, reference is made to "monetary expansion;" another part of the directive speaks of "relating the supply of funds in the market to the needs of commerce and business."

(*a*) What does the Committee mean by "credit expansion"? Does this refer to the expansion in total loans and investments of commercial banks? Does it refer to the expansion of total public and priavte debt? Or does it refer to bank deposit expansion?

(*b*) What does the Committee mean by "monetary expansion"? Does this refer to expansion of the money supply? Including or excluding time deposits of commercial banks?

(*c*) What is the meaning of "relating the supply of funds in the market to the needs of commerce and business"? Does this statement say any more than that the supply of funds should equal the demand for funds? And isn't this statement meaningful only when it is related to the "price" (i.e., interest rates) of such funds? If, at the equilibrium level of interest rates, the supply of funds is always equal to the demand for funds, then what significance has this statement in the policy directive?

(*d*) In the revision of May 24, "moderate bank credit expansion" is mentioned as a policy goal. Does this mean moderate expansion of commercial banks' loans and investments? Or is the goal confined to the expansion of demand deposits? Or to demand deposits plus time deposits?

(*e*) In the revision of August 16, "encouraging monetary expansion" is stated as a policy goal. Does this mean expansion of the money supply, including demand deposits and currency outside of banks? Or does it refer to something else?

2. What is the reason for limiting increases or decreases in security holdings in the System account to $1 billion? Is it the intention of this instruction not to upset the bond markets? Why was the limit raised temporarily to $1.5 billion?

3. Why did the Committee instruct the New York bank, on August 16, to "take into account, even more than usual, the tone of the market rather than statistical measures"? What were the statistical measures? Was this instruction issued because of the change in status of vault cash? If so, did the change in status of vault cash render "free reserves" a misleading statistical measure?

Economic indicators considered by Committee

The Board of Governors and the Federal Open Market Committee look at a wide range of economic indicators to aid them in decisions on monetary policy. These economic indicators include industrial production, interest rates, employment and unemployment levels, balance of payments, inventories, and so on.[11] When the indicators suggest that economic activity is declining, the Federal Reserve will ordinarily pursue an easier monetary policy; under opposite circumstances, a policy of monetary tightness is ordinarily followed.

The use of the economic indicators and the policies resulting from the study of them raise several questions.

1. Suppose that economic activity is receding. When the Federal Reserve, in the light of such economic conditions, lowers reserve requirements, reduces discount rates, and conducts open market purchases of Government securities, in exactly what way are these actions supposed to affect levels of employment, prices, and output? Will these monetary actions affect levels of interest rates? Will they affect the price level? Will they affect the employment and output levels? In each case, what is the mechanism by which the monetary actions affect the particular economic variable?

2. On page 7 of the annual report, it is stated: "Continual gradual change in the occupational structure and location of employment made reemployment difficult for many of the unemployed. At the same time improved technology and equipment continued to reduce manpower requirements in many industries." Does the Board look upon a large part of the present level of unemployment as "structural"? If so, can this view be justified by the data, especially in view of the study by the Council of Economic Advisers on this matter (which concluded that structural unemployment was not serious)? If so, does this mean that monetary actions cannot much affect the structural type of unemployment?

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[11] See the summaries of meetings of the Open Market Committee, pp. 35–75, for a brief discussion of these and other economic indicators.

Does the view that a large part of unemployment is "structural" inhibit the Board from following easier monetary policies than it otherwise would?

3. What combinations of economic indictors prompted the Federal Open Market Committee to revise its policy directive? How seriously are regional indicators of business activity considered in making policy decisons? Does the Committee utilize a forecasting technique based on the direction and extent of movement of several economic indicators? Based on other things? Does the Committee utilize the National Bureau of Economic Research's technique of forecasting economic activity? Various techniques for forecasting the level of GNP, with or without the use of high-speed computers, have been developed in recent years. Has the Board given any thought to utilizing such techniques? Has the Committee's method of analyzing economic indicators changed in any substantive way during the past decade? If so, in what ways? If not, does the Committee feel that it is making best use of known techniques for analyzing economic data? Has the Committee investigated the forecasting methods currently being used in any of the universities? Has the Committee received any expert advice in recent years along these lines?

4. On pages 18 to 21 of the annual report, there is a discussion of the growth of nonmonetary liquid assets in 1960. The liquid assets referred to in the report are mutual savings deposits, time deposits in commercial banks, savings and loan shares, U.S. savings bonds, and short-term U.S. Government securities.

However, there is nothing in this discussion to indicate precisely the view of the Board regarding the impact of these liquid assets on economic activity. When these liquid assets grow, do they create inflationary pressure in the economy, or deflationary pressure? Or does their growth have neutral effects on economic activity?

At one point, there is some indication that the Board considers the growth of time deposits in commercial banks as having expansionary effects on economic activity. The report states: "Thus, most of the expansion in commercial bank credit during 1960 was reflected in increases in time and savings deposits." [12] Does this mean that an increase in time and savings deposits, by being associated with an increase in banks' loans and investments, is stimulating to general economic activity? Has the Board ever stated its views along these lines with respect to the growth of time deposits? Does the Board attempt to hold back the growth of time deposits in commercial banks during periods of inflationary pressure? During such periods, does the Board reduce the growth of the money supply in order to offset the rapid growth of other liquid assets, such as time deposits? In short, what precisely is Federal Reserve policy with respect to time deposits?

At another point, it is indicated that, although the money supply contracted in the first half of the year, policy was not as restrictive as this because it was "accompanied by a continued increase in nonbank holdings of Government securities and other liquid assets." [13] In this statement, does "accompanied" mean "offset"? That is, does the Board consider the growth in nonbank holdings of Government securities and other liquid assets to have an expansionary impact on levels of prices, output, and employment? If so, does this mean that growth in the money supply is consciously held back by the Board to compensate for growth in other liquid assets? If not, what sort of an impact on economic activity does such growth have? And what is the implication of such growth for monetary policy?

ACTIONS BASED ON POLICY DIRECTIVES AND DECISIONS

After studying economic indicators and other evidence, the Board of Governors and the Federal Open Market Committee decide on courses of action with respect to open market operations, reserve requirements and total reserves, margin requirements, and discount rates. In regard to open market operations, the Committee issues a policy directive which is supposed to guide the manager of the System account in his execution of such operations. In regard to member bank reserves, all is presumably well if the member banks react to changes in their reserves in ways anticipated (and desired) by the Committee and by the Board. In both cases, signals are sent out by the Committee and the Board, and these signals are supposed to spark appropriate actions. The question is, Do they? And, if so, how?

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[12] P. 19.
[13] Ibid.

Open market operations

When the policy directive, adopted by the Federal Open Market Committee, changes from "restraining inflationary pressures" to "guarding against inflationary pressures" to "providing reserves for moderate bank credit expansion," and so on, it is puzzling how the manager of the System account is supposed to translate the revised policy statement into open market purchases and sales. Presumably, the official minutes of the meetings of the Open Market Committee contain a full range of instructions given to the manager of the System account. But from the résumé of these meetings in the annual report it is difficult to get clues as to what these might be.

All that one can infer from the policy directives in 1960 is that the Committee sought to have open market operations move in the direction of less restraint and more ease, until perhaps the words were added "taking into consideration current international developments." But the degree of restraint or ease intended by the various versions of the directive is shrouded in mystery because, standing by themselves, the revisions in language appear to have very little operational meaning.

It is stated in the annual report that: "The manager of the System open market account attends the meetings of the Committee, and the shades of opinion expressed at those meetings provide him with guides to be used in the conduct of open market operations, within the framework of the policy directive adopted by the Committee." [14]

Several questions may be posed about these procedures.

1. For each revision of the policy directive, what, specifically, did the change in language mean as a working directive to "the Desk"? How, specifically, was the policy directive translated into actions, first as to urgency and second as to quantity?

2. Does the large size of the Open Market Committee have anything to do with the vague and very general wording of the policy directive? If the Committee contained fewer members, is it more probable that the policy directive would be more specific?

3. Does the Manager of the open market account have daily contacts with the Board of Governors? If so, what is the nature and purpose of such contacts? If such contacts occur, is the manager of the account given specific instructions as to purchases and sales of securities for that day?

4. Does the statement in the annual report pertaining to "shades of opinion," quoted above, mean that the manager of the account will make greater or smaller net purchases of securities depending on the number voting against the wording of the directive? If not, what does it mean? How is it possible for the manager of the account to translate "shades of opinion" into dollar amounts of purchases or sales?

Reserves and reserve requirements

The Board of Governors, during the year, allowed member banks to count vault cash as part of their required reserves. At the same time, reserve requirements on demand deposits were lowered twice for central reserve city banks and raised once for country banks. The net result of these actions was to increase the total reserves and the excess reserves of the member banks.

However, there is evidence that the country banks, which hold most of the vault cash, did not utilize the additional excess reserves provided to them by the above actions. That is to say, there is evidence that the policy decisions of the Board and the Open Market Committee with respect to member bank reserves were not translated into the sort of action by the banks that was anticipated by Federal Reserve officials.

1. Is there any evidence that member banks desire to hold a larger volume of free reserves now that vault cash counts as part of required reserves? If so, what is the reason for this behavior?

2. Was the change in status of vault cash during the year the reason for the Committee's instruction on August 16 that open market operations "should take into account, even more than usual, the tone of the market rather than statistical measures"? In particular, does this means that the statistical measure of "free reserves" was no longer reliable after the status of vault cash was altered?

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[14] P. 34.

INFLUENCE OF MONETARY ACTIONS ON ECONOMIC INDICATORS

Open market operations, changes in reserve requirements, and other monetary actions are meant, in the first instance, to influence the reserve status of member banks and the money supply. Changes in reserves and in the money supply are presumably made for the purpose of affecting either directly or indirectly, the levels of prices, output, and employment.

Money supply

It is stated in the annual report: "Early in 1960 the policy of restraining credit and monetary expansion that had been in effect in 1959 was relaxed, and in ensuing months policy began actively to stimulate such expansion."[15] However, money supply data, recorded in table 2, show that, despite the Board's desire for expansion, very little happened to the money supply during the year. The figures in the table indicate that the money supply fell during the first half of the year and then rose slightly during the second half.

It can also be seen that the money supply at the end of 1960 was about $1 billion below its level of December 1959. Furthermore, the money supply was somewhat lower at the end of 1960 than it was in March of that year. Also, it should be noted, the money supply fell by $1.4 billion from the first half of March to June, during the very months when the Board had switched to a policy of less restraint. Moreover, even during the last half of the year, when the Board was pursuing a policy of active ease, the money supply rose by only $1 billion.

There are many references in the summaries of the meetings of the Open Market Committee to the money supply. There is frequently a note of surprise that the money supply failed to increase or to respond as anticipated to monetary policies. For example, on March 22, it is stated: "Currently available figures indicated that the money supply, defined in terms of currency and demand deposits, had declined by about a billion dollars in February, accompanied by an accelerated rate of deposit turnover, and preliminary statistics for early March suggested that the downward trend of the money supply had not been reversed."[16]

Another example of this occurred on May 24: "The consensus resulting from evaluation of the current situation favored a further supplying of reserves through open market operations with a view to permitting a moderate expansion of bank credit and encouraging an increase in the money supply, which thus far had failed to respond to the easing steps taken by monetary policy."[17]

And, on September 13: "On the financial side, the August statistics on bank credit and the money supply were disappointing, the increase in both the figures having been rather small and less than in July."[18]

TABLE 2.—*Monthly supply, seasonally adjusted, semimonthly*[1]

	Money supply (Billions)		*Money supply (Billions)*
1959—		1960—Continued	
Dec. 1	141.5	June 2	139.4
Dec. 2	141.5	July 1	139.6
1960—		July 2	139.7
Jan. 1	141.3	Aug. 1	139.7
Jan. 2	141.3	Aug. 2	139.8
Feb. 1	141.1	Sept. 1	140.3
Feb. 2	140.9	Sept. 2	140.5
Mar. 1	140.8	Oct. 1	140.0
Mar. 2	140.3	Oct. 2	141.2
Apr. 1	140.3	Nov. 1	140.6
Apr. 2	140.7	Nov. 2	139.9
May 1	141.2	Dec. 1	140.3
May 2	139.6	Dec. 2	140.5
June 1	139.4		

[1] Federal Reserve Bulletin, October 1960, April 1961.

[15] P. 7.
[16] P. 46.
[17] P. 55.
[18] P. 64.

The sluggish behavior of the money supply during 1960 raises a number of questions.

1. Presumably the Federal Reserve can always increase the money supply in a direct way by purchasing Government securities. The checks issued by the Federal Reserve to pay for such purchases will be deposited in commercial banks, and hence the money supply will rise. Even though there may be offsetting factors, the Federal Reserve can always bring about any net increase in the money supply it desires through open market operations. In view of this, why did the money supply continue to fall during the first half of the year, especially from March to June, when it was apparently the goal of the Board to increase it? Why should changes in the money supply be "disappointing," as they apparently were for August, when open market operations within a few days could have corrected this?

2. The year 1960 was characterized, at first, by a leveling off of economic activity, and then by a downturn in economic activity. The year as a whole was one of sluggishness and recession. In view of this, why was the money supply permitted to fall by $1 billion for the year as a whole? Should it not have been increased? What were the factors that induced the Board to allow the money supply to decline by $1 billion for the year? Was this choice dictated by the international balance of payments? by the growth of other types of liquid assets, including time deposits in commercial banks?

Member bank reserves

During the year, total reserves of member banks were increased from $18.9 to $19.3 billion. At the same time, excess reserves rose slightly, while free reserves increased by more than $1 billion. Excess reserves are equal to total reserves less required reserves. Free reserves are equal to excess reserves less member bank borrowings from the Federal Reserve. Data on reserves are recorded in table 3.

TABLE 3.—*Total reserves, excess reserves, free reserves, averages of daily figures* [1]

[In billions of dollars]

	Total reserves	Excess reserves	Free reserves		Total reserves	Excess reserves	Free reserves
1959—December	18.9	0.5	−0.4	1960—July	18.5	0.5	0.1
1960—January	18.9	.5	−.4	August	18.5	.5	.2
February	18.2	.5	−.4	September	18.6	.6	.4
March	18.0	.4	−.2	October	18.7	.6	.5
April	18.1	.4	−.2	November	19.0	.8	.6
May	18.2	.5	0	December	19.3	.8	.7
June	18.3	.5	0				

[1] Federal Reserve Bulletin, August 1960, April 1961.

As noted above, the Board seems to have been disappointed in the small increase in the money supply from about March to September. However, over these months total reserves of member banks rose very little and excess reserves hardly at all. Free reserves rose because member banks repaid borrowings from the Federal Reserve. It appears, therefore, that the commercial banks were not supplied with sufficient reserves to induce them to increase to any significant extent their demand deposit liabilities.

1. If the above analysis is correct, why were the banks not supplied with more reserves? Why were total reserves permitted to rise by only $0.4 billion for the year as a whole? Is it not the small increase in total reserves that explains the failure of the money supply to rise throughout the year as a whole?

2. Did member banks fail to utilize their excess (or free) reserves to a greater extent in 1960 than in previous recession years? In the event, was the Board surprised by the behavior of member banks toward their excess (or free) reserves? If so, what accounts for this behavior? If not, was it not inevitable that the money supply would turn in a sluggish performance, given the small increase in total reserves for the year? Why, then, was the Board surprised at the decline in the money supply during part of the year, or by the small gains in the money supply at other times?

3. Is the level of free reserves a key indicator of the effectiveness of Federal Reserve policy? Does the Board attempt to estimate the member banks' demand for free reserves, as well as the supply of these reserves? Is it now the belief of the Board that the demand for free reserves rose sharply during 1960? If so, is it not true that more monetary ease could have been achieved only by supply free reserves in excess of the demand for them? Was the demand for free reserves during the year affected by the changed status of vault cash? Did this change in status of vault cash upset to any great extent the calculations of the Board or the Open Market Committee concerning the amount of free reserves to supply to the banking system? Does the manager of the system account pay strict attention to the level of free reserves? How are these data taken into account by the manager of the system account?

4. Does the rate of interest on Federal funds influence the direction and extent of open market operations? If so, in what way?

Rates of interest

Throughout the postwar period, there has been a close relationship between rates of interest and the ratio of the money supply to gross national product. One such relationship is plotted in chart 1, that between the corporate Aaa bond rate and the money-GNP ratio. For extended periods since 1946, the chart shows that the corporate bond rate rose whenever the ratio of money to GNP fell. That is to say, the corporate bond rate rose whenever the growth of the money supply lagged behind the growth of GNP. Under opposite circumstances, the corporate bond rate fell. In general, the same relationship is found between the money-GNP ratio and long-term interest rates on Government securities, and between the money-GNP ratio and any of several short-term interest rates.

As a consequence, it is fairly clear that the Federal Reserve System, by controlling the money supply, is able to establish levels of long-term and short-term interest rates, within fairly narrow limits. All of these rates are strongly under the influence of monetary policy.

The behavior of some interest rates during 1960 is shown in table 4. There it may be seen that, generally speaking, interest rates fell during the year. However, there was very little decline in long-term rates of interest after June; in fact, the Government bond rate was higher in December than it had been in July, while the corporate bond rate in December was not far below its level of April. All in all, the decline in long-term interest rates during the past recession was significantly smaller than it had been in the two preceding recessions. Short-term interest rates fell sharply until August, and then showed some tendency to rise after that.

TABLE 4.—*Interest rates* [1]

	Taxable U.S. Government bonds	Corporate Aaa bonds	3-month Treasury bills [2]		Taxable U.S. Government bonds	Corporate Aaa bonds	3-month Treasury bills [2]
1959—December	4.27	4.58	4.57	1960—July	3.86	4.41	2.40
1960—January	4.37	4.61	4.44	August	3.79	4.28	2.29
February	4.22	4.56	3.95	September	3.84	4.25	2.49
March	4.08	4.49	3.44	October	3.91	4.30	2.43
April	4.18	4.45	3.24	November	3.93	4.31	2.38
May	4.16	4.46	3.39	December	3.88	4.35	2.27
June	3.98	4.45	2.64				

[1] Economic Report of the President, January 1961.
[2] Rate on new issues.

1. Is it the view of the Federal Reserve that there is a close relationship between the ratio of money to GNP and interest rates on corporate and Government bonds? In particular, is the Federal Reserve able, through its control over the money supply, to influence strongly the levels of interest rates? If so, a sharper drop in long-term interest rates during 1960 must have been contrary to Federal Reserve policy: is this correct? If not, what were the factors influencing interest rates during 1960? Did the Federal Reserve attempt to push long-term rates lower, only to fail? If so, what were the causes of the failure?

2. During the last half of the year, the Federal Reserve was pursuing a policy of active ease for the purpose of "fostering sustainable growth in economic

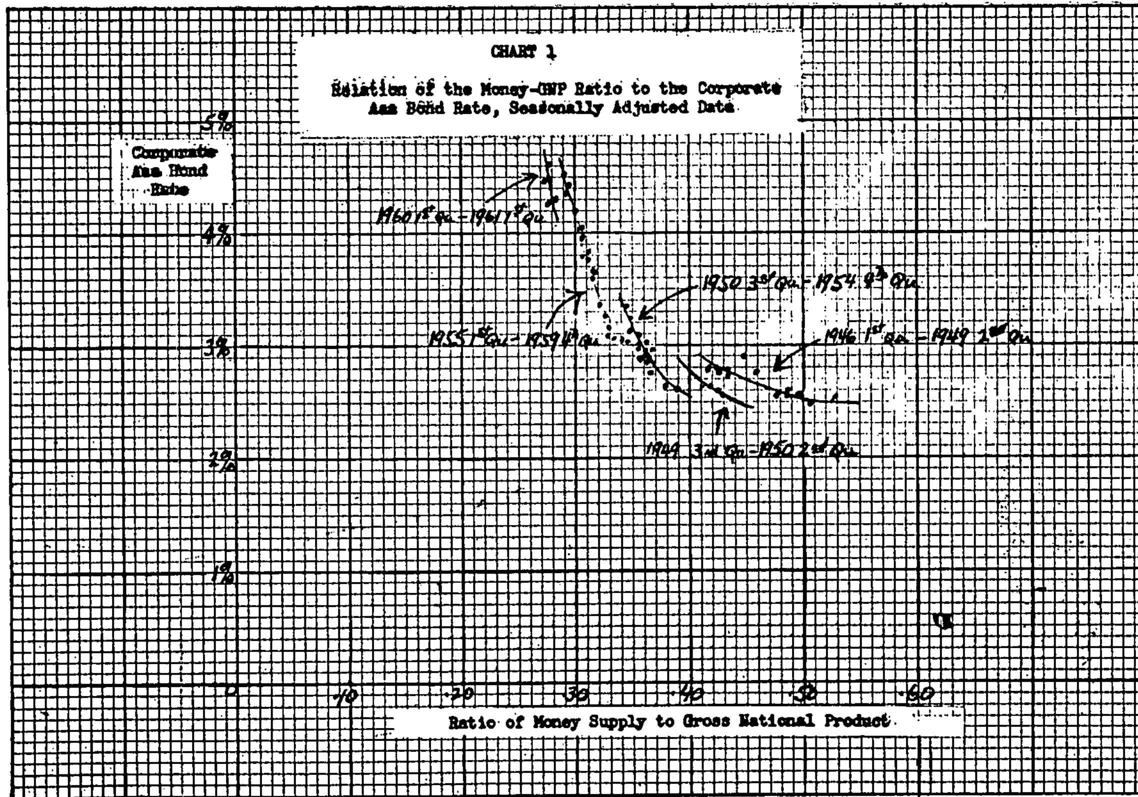


CHART 1

Relation of the Money-GNP Ratio to the Corporate Aaa Bond Rate, Seasonally Adjusted Data

activity." And yet the long-term interest rates remained at high levels throughout these months. How can this be reconciled with the goals of the Federal Reserve?

3. Was it the policy of the Federal Reserve, in the latter part of the year, to raise short-term rates while lowering long-term rates? If so, in what ways did the System attempt to achieve such an aim? Does the manager of the System account ever buy long-term securities and sell short-term securities on the same day in approximately equal amounts, for the purpose of influencing the structure of interest rates, and not for the purpose of affecting reserve positions of member banks? More specifically, does the manager of the System account ever act principally as a debt manager rather than as a monetary manager? If there are objections to such behavior, what are they? Why are there self-imposed limits to aggregate amounts of increases and decreases in security holdings in the System account from one meeting to the next of the Open Market Committee?

4. In purchasing and selling securities, does the manager of the System account ever assume an active, forceful role—by purchasing securities, say, above the present market price, or by selling them, say, below the current market price, for the purpose of changing the level of rates? What would be the objections to such behavior?

5. If it is true that the manager of the System account never sells and buys securities for the principal purpose of influencing the structure of rates, that there are self-imposed limits to increases and decreases in security holdings, that the manager never takes a forceful role for the purpose of directly affecting security prices—if all of these things are true, do they not indicate that the Federal Reserve is over-solicitous of the bond market? Should not the bond market be considered a means to an end—as a means of influencing behavior on the labor and goods market, and not as an end in itself?

Levels of output, employment, and prices

1. What influence does the Board believe that monetary policies had on levels of national output during 1960? Did monetary policies have any effect on consumption expenditures? on expenditures for inventories by business firms? on residential construction? on State and local government expenditures? In each case, what is the evidence? If effects are not known, then what justification is there for the belief that the correct monetary policies were pursued in 1960?

2. What influence does the Board believe that monetary policies had on price levels during 1960? What is the evidence?

3. What influence does the Board believe that monetary policies had on levels of employment and unemployment during 1960? What is the evidence?

(Tables and charts prepared by the staff, some supplied by the Board's staff:)

FEDERAL RESERVE SYSTEM HEARINGS ON ANNUAL REPORT, 1960

LIST OF ATTACHED COMMITTEE MATERIALS

1. Monetary policy directives and changes, 1960, as reported in "Record of Policy Actions."
2. Money supply, chart.
3. Reserves of member banks, chart.
4. Excess reserves and borrowings of member banks, chart.
5. Discount and prime rate, chart.
6. Yields on U.S. Government securities, chart.
7. Bank loans and investments, all commercial banks, chart.
8. Money supply and reserves and borrowings of member banks, table.
9. U.S. Government security and corporate bond yields, table.
10. All commercial banks, loans, and investments, table.
11. Maturity distribution of U.S. Government securities held by Federal Reserve banks, January 1, 1960, and January–May 1961, table.
12. Market rates on U.S. Government securities, January–May 1961, table.
13. Expansion and recessions defined by roughly coincident series, 1957–61, chart.

FEDERAL RESERVE SYSTEM MONETARY POLICY DIRECTIVES AND CHANGES, 1960 AS REPORTED IN "RECORD OF POLICY ACTIONS," ANNUAL REPORT, 1960

A. March 1, 1960, Open Market Committee: Directive in effect from May 26, 1959, "* * * *restraining inflationary credit expansion* in order to foster sustain-

able economic growth and expanding employment opportunities" changed to read "* * * fostering sustainable growth in economic activity and employment *while guarding against excessive credit expansion*" (p. 41).

B. May 24, 1960, Open Market Committee: "* * * fostering sustainable growth in economic activity and employment by *providing reserves needed for moderate bank credit expansion*" (p. 54).

C. June 2, 1960, Board of Governors: Approved reduction in discount rate one-half percentage point from 4 percent to 3½ percent (p. 80).

D. July 28, 1960, Board of Governors: Reduced margin requirement for purchase or carrying registered stocks from 90 percent to 70 percent (p. 81).

E. August 11, 1960, Board of Governors: Approved reduction in discount rate one-half percentage point from 3½ percent to 3 percent (p. 85).

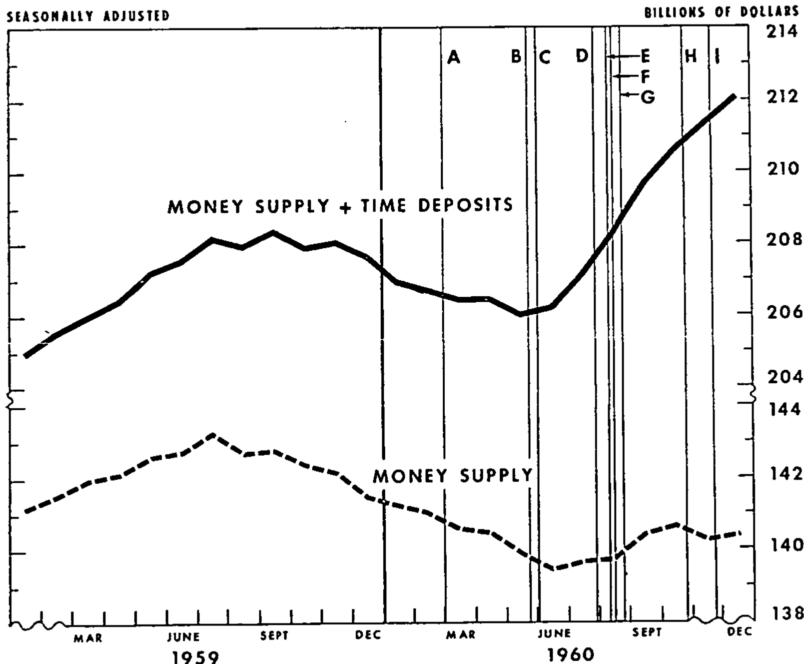
F. August 16, 1960, Open Market Committee: "* * * *encouraging monetary expansion* for the purpose of fostering sustainable growth in economic activity and employment" (p. 61).

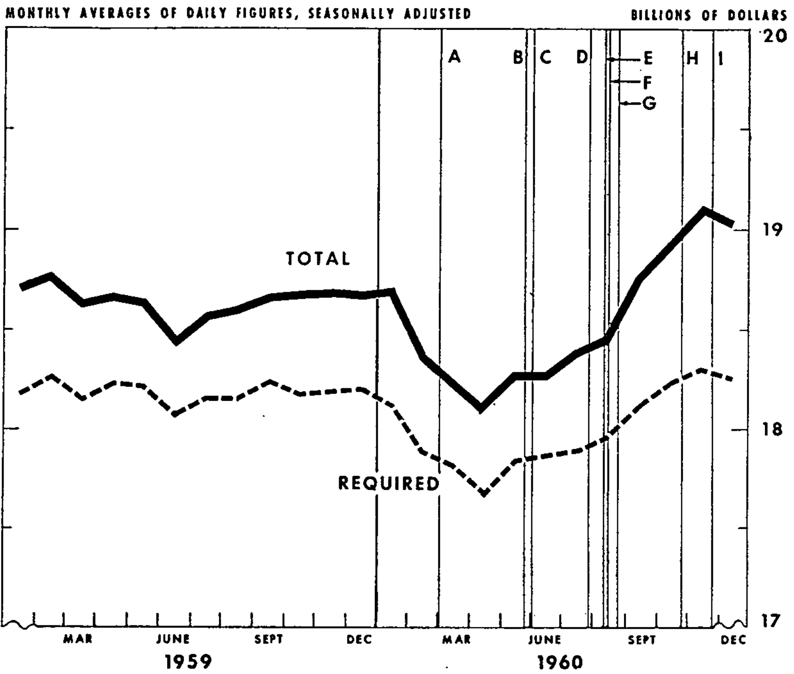
G. August 25, 1960, Board of Governors: Pursuant to action announced August 8, 1960, permitted member banks not classified as central Reserve city or Reserve city banks to count vault cash in excess of 2½ percent (rather than 4 percent) of net demand deposits as part of required reserves, and effective September 1, permitted central Reserve city and Reserve city banks similarly to count vault cash in excess of 1 percent (rather than 2 percent) of net demand deposits. Effective September 1 reduced reserve requirements of central Reserve city banks from 18 percent to 17½ percent (p. 83).

H. October 25, 1960, Open Market Committee: Amended August 16 directive to add the words "*while taking into consideration current international developments*" (p. 67).

I. November 24, 1960, Board of Governors: Pursuant to action announced October 26, 1960, permitted banks to count all bulk cash as part of required reserves; increased reserve requirements at central Reserve or Reserve city banks from 11 percent to 12 percent; and effective December 1, reduced reserve requirements of central Reserve city banks against demand deposits from 17½ percent to 16½ percent (p. 87).

NOTE.—Italic added by JEC staff.

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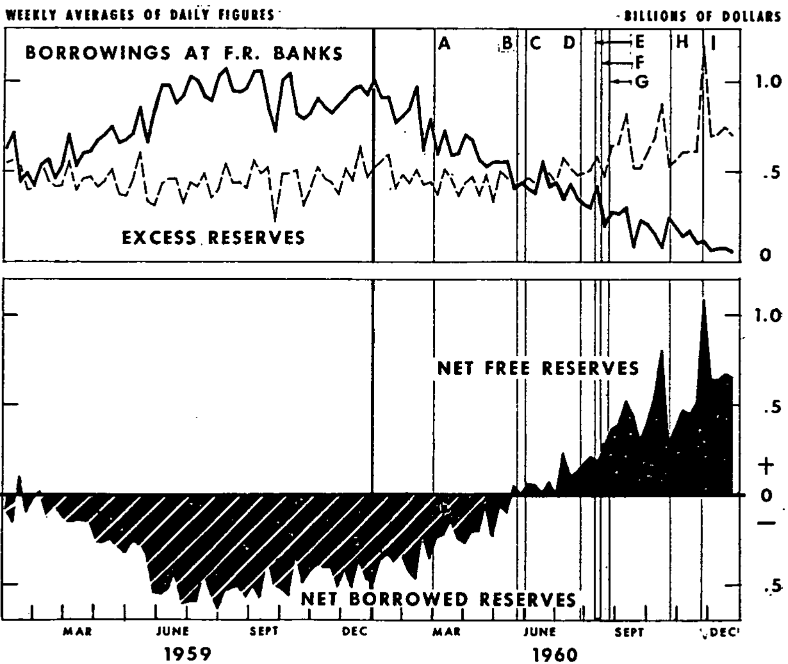
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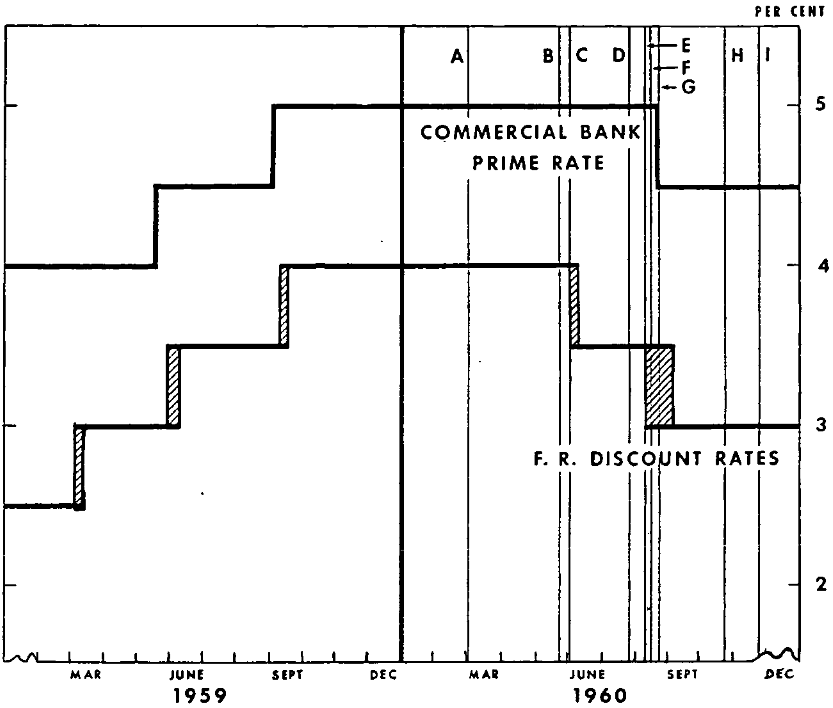
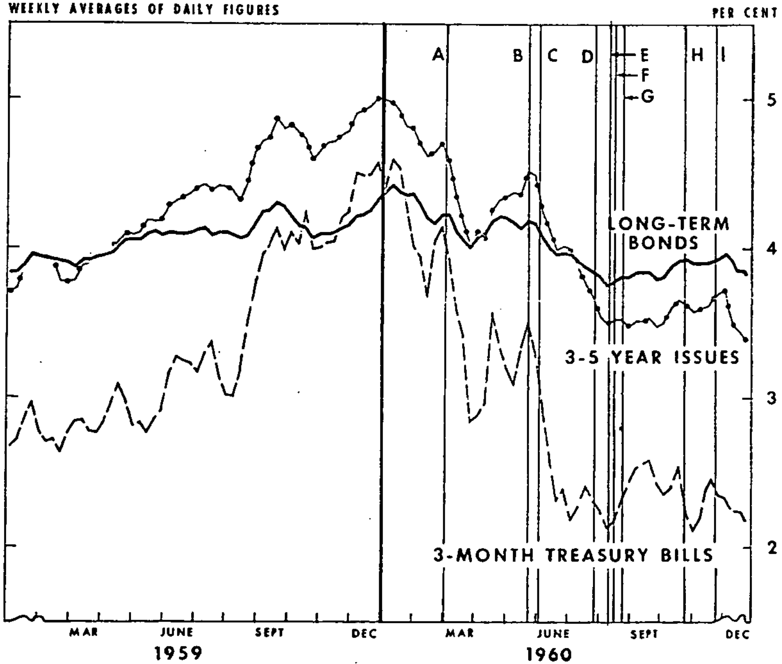
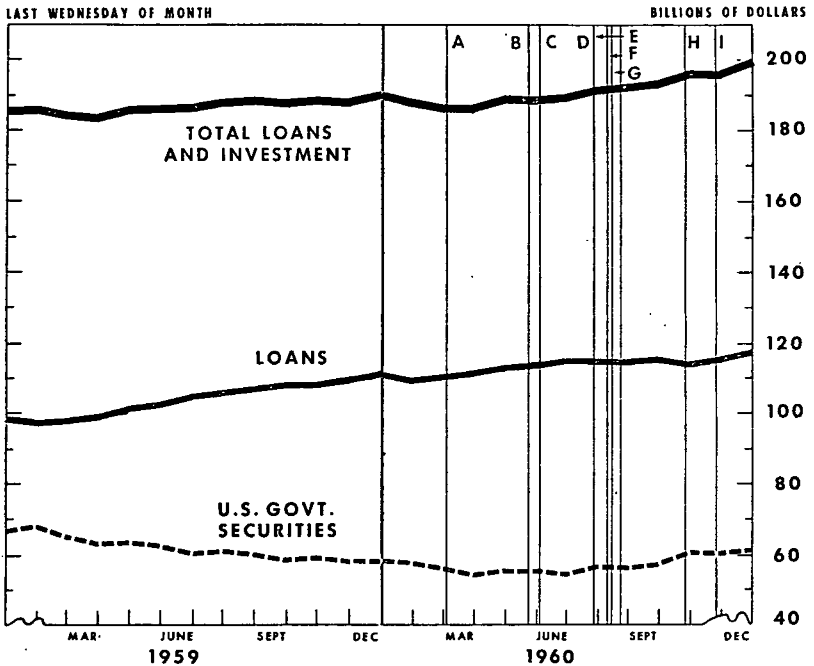
DISCOUNT AND PRIME RATE



YIELDS ON U.S. GOVERNMENT SECURITIES

WEEKLY AVERAGES OF DAILY FIGURES





Money supply and reserves and borrowings of member banks monthly 1959–61
(Averages of daily figures)

Period	Money supply [1] (seasonally adjusted)	Money supply plus time deposits [2] (seasonally adjusted)	All member banks: Total reserves held	All member banks: Borrowings at Federal Reserve banks	All member banks: Free reserves
	Billions	*Billions*	*Millions*	*Millions*	*Millions*
1959—January	$141.2	$205.0	$18,893	$557	−$59
February	141.6	205.6	18,577	508	−48
March	142.0	206.0	18,429	601	−140
April	142.1	206.4	18,644	676	−259
May	142.6	207.2	18,580	767	−319
June	142.8	207.6	18,451	921	−513
July	143.3	208.2	18,671	957	−557
August	142.7	207.9	18,613	1,007	−535
September	142.8	208.4	18,593	903	−493
October	142.4	207.9	18,610	905	−459
November	142.2	208.1	18,621	878	−433
December	141.5	207.7	18,932	906	−424
1960—January	141.3	207.0	18,878	905	−361
February	141.1	206.8	18,213	816	−361
March	140.6	206.5	18,027	635	−219
April	140.5	206.5	18,104	602	−194
May	139.9	206.0	18,239	502	−33
June	139.4	206.2	18,294	425	41
July	139.6	207.1	18,518	388	120
August	139.7	208.3	18,501	293	247
September	140.4	209.7	18,570	225	414
October	140.6	210.6	18,733	149	489
November	140.2	211.3	19,004	142	614
December	140.4	212.1	19,283	87	682
1961—January	140.6	212.8	19,315	49	696
February	141.2	214.9	18,964	137	517
March	141.5	215.6	18,809	70	476
April	142.0	216.8	18,884	57	562

[1] Currency outside banks plus demand deposits at all commercial banks.
[2] Time deposits at all commercial banks, end of month.

U.S. Government security and corporate bond yields, monthly 1959–61

[Percent per annum]

Period	U.S. Government		Corporate bonds (Moody's) Aaa
	3-month Treasury bills	Taxable bonds	
1959—January	2.837	3.90	4.12
February	2.712	3.92	4.14
March	2.852	3.92	4.13
April	2.960	4.01	4.23
May	2.851	4.08	4.37
June	3.247	4.09	4.46
July	3.243	4.11	4.47
August	3.358	4.10	4.43
September	3.998	4.26	4.52
October	4.117	4.11	4.57
November	4.209	4.12	4.56
December	4.572	4.27	4.58
1960—January	4.436	4.37	4.61
February	3.954	4.22	4.56
March	3.439	4.08	4.49
April	3.244	4.18	4.45
May	3.392	4.16	4.46
June	2.641	3.98	4.45
July	2.396	3.86	4.41
August	2.286	3.79	4.28
September	2.489	3.84	4.25
October	2.426	3.91	4.30
November	2.384	3.93	4.31
December	2.272	3.88	4.35
1961—January	2.302	3.89	4.32
February	2.408	3.81	4.27
March	2.420	3.78	4.22
April	2.327	3.80	4.25

Source: Economic Indicators.

All commercial banks, loans, and investments, monthly 1959–61

[Billions of dollars]

Period	Total loans and investments	Loans	Investments	
			U.S. Government securities	Other securities
1959—January	185.6	97.7	67.5	20.4
February	183.8	97.9	65.5	20.4
March	182.9	99.2	63.2	20.6
April	185.7	101.2	63.6	20.9
May	185.8	102.4	62.6	20.8
June	185.9	104.5	60.9	20.6
July	187.7	105.9	61.1	20.6
August	188.2	107.4	60.3	20.5
September	187.8	107.8	59.2	20.7
October	188.4	108.2	59.6	20.6
November	188.3	109.5	58.5	20.3
December	190.3	110.8	58.9	20.5
1960—January	187.8	109.6	58.0	20.3
February	186.5	110.3	56.2	20.1
March	185.7	111.4	54.2	20.1
April	188.8	113.0	55.8	20.0
May	188.6	113.6	55.1	19.8
June	188.9	114.8	54.2	20.9
July	190.9	114.2	56.7	20.0
August	191.2	114.7	56.6	20.0
September	193.3	115.4	57.7	20.2
October	195.6	114.8	60.4	20.4
November	195.5	115.0	60.2	20.3
December	199.5	117.6	61.0	20.9
1961—January	197.0	114.2	61.9	20.9
February	199.3	116.7	61.3	21.3
March	198.0	116.6	59.7	20.7
April [1]	199.7	117.2	60.7	20.8

[1] Preliminary.

Source: Board of Governors of the Federal Reserve System.

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Maturity distribution of U.S. Government securities held by Federal Reserve banks, Jan. 1, 1960 and January–May, 1961

[In millions of dollars]

Date	Total	Over 5 years	Date	Total	Over 5 years
Jan. 1, 1960	26,648	1,470	Mar. 29, 1961	26,688	1,522
Jan. 1, 1961	27,384	1,440	Apr. 5, 1961	27,127	1,914
Feb. 1, 1961	26,695	1,450	Apr. 12, 1961	26,809	1,956
Feb. 8, 1961	27,061	1,450	Apr. 19, 1961	26,436	1,967
Feb. 15, 1961	27,161	1,450	Apr. 26, 1961	26,228	2,004
Feb. 22, 1961	26,701	1,456	May 3, 1961	26,781	2,021
Mar. 1, 1961	26,667	1,460	May 10, 1961	26,916	2,118
Mar. 8, 1961	26,920	1,495	May 17, 1961	26,667	2,151
Mar. 15, 1961	27,014	1,513	May 24, 1961	26,747	2,217
Mar. 22, 1961	26,759	1,513			

Source: Board of Governors of the Federal Reserve System.

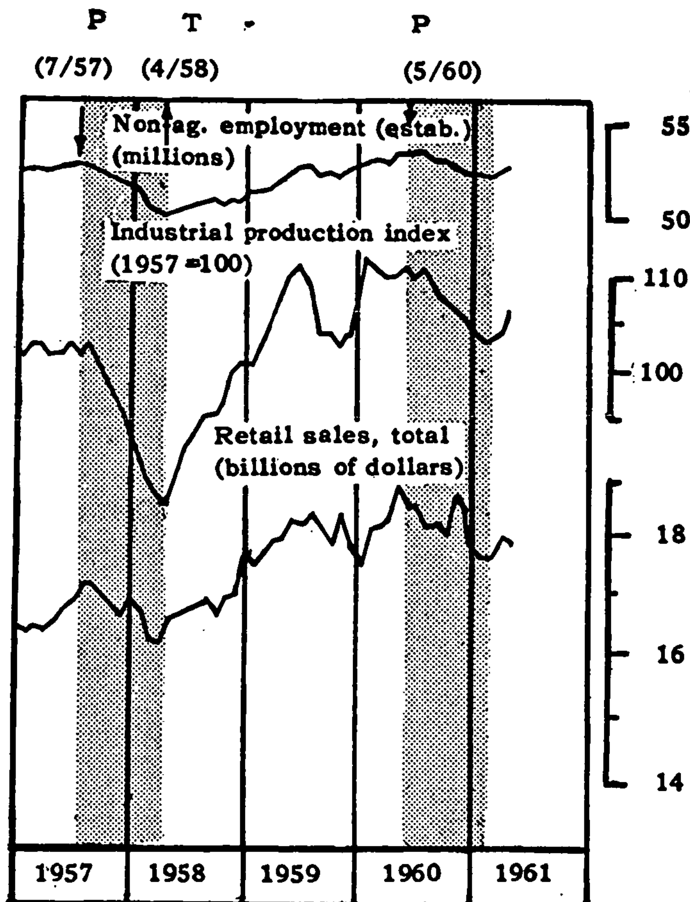
Market rates on U.S. Government securities, January–May 1961

[Percent per annum basis]

Week ending—	3-month bills (rate on new issues)	3- to 5-year issues	Long term (10 years or more)
1961—Jan. 7	2.234	3.39	3.84
Jan. 14	2,385	3.52	3.90
Jan. 21	2.358	3.59	3.92
Jan. 28	2.230	3.57	3.89
Feb. 4	2.299	3.57	3.88
Feb. 11	2.374	3.56	3.84
Feb. 18	2.462	3.56	3.81
Feb. 25	2.496	3.48	3.76
Mar. 4	2.594	3.49	3.77
Mar. 11	2.485	3.36	3.75
Mar. 18	2.352	3.44	3.78
Mar. 25	2.278	3.45	3.80
Apr. 1	2 392	3.43	3.81
Apr. 8	2.470	3.45	3.82
Apr. 15	2.360	3.40	3.81
Apr. 22	2 292	3.38	3.81
Apr. 29	2.186	3.32	3.78
May 6	2.300	3.23	3.72
May 13	2.232	3.15	3.70
May 20	2.264	3.24	3.71
May 27	2.354	3.43	3.78

Source: Board of Governors of the Federal Reserve System.

EXPANSIONS AND RECESSIONS DEFINED BY ROUGHLY COINCIDENT SERIES 1957 - 1961



(By Mr. James Knowles of the committee staff:)

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

MAY 31, 1961.

Memorandum

To: Wm. Summers Johnson, Executive Director.
From: James W. Knowles, staff economist.
Subject: The economic analysis summarized in the 1960 Annual Report of the Board of Governors of the Federal Reserve System.

You asked me to appraise the summaries of the economic situation which were published in the 1960 Annual Report of the Board of Governors of the Federal Reserve System as part of the record of policy actions by the Open Market Committee during last year.

For the 17 meetings held by the Open Market Committee during 1960, I have compared the economic summaries with Economic Indicators, the Survey of Current Business, etc., as well as with my file of forecasts for 1960 made by various private individuals and organizations.

Appraisal of the meeting-by-meeting summaries in the annual report are made difficult by two characteristics:

(1) The descriptions of the economic situation and of the analysis made by the members of the Open Market Committee or by their economic advisers are not inclusive, detailed, and specific enough; and

(2) Although it is obvious from the text that the Open Market Committee was given appraisals of the economic outlook, these outlook statements or forecasts are not stated explicitly enough for them to be evaluated. Moreover, their attribution is not clear—were the forecasts or outlook statements prepared by the committee's advisers, by the committee itself, or by outside individuals or organizations?

Although detailed appraisal of these economic summaries is not worthwhile, or indeed possible, certain more or less impressionistic conclusions concerning the quality of these summaries of the economic situation and outlook can be reached:

1. The specific facts cited, and the verbal summaries of the economic situation, as might be expected, agree with those presented in publications by Federal and private agencies at the time of each meeting. In a word, the economic reporting to the Open Market Committee appears to have been carried out thoroughly and competently.

2. The analysis and interpretation of the facts agree generally with those being made contemporaneously by other economists in and out of Government. The change in appraisal from one of "extreme optimism" in early January to one of expectation for "an extension of the sideways movement or some downward drift" by September is in general accord with the gradual shift in outlook sentiment in the Nation at large. It is well to recall that it was not until November and December that general acknowledgment of the existence of the recession developed. In fact, the first public recording in a Government source of the existence of the recession probably was in the hearings on the "Current Economic Situation and Short-Run Outlook," held on December 7 and 8, 1960, by the Joint Economic Committee.

3. Whatever may have been the detailed economic analysis and outlook which the Board's report summarizes somewhat vaguely for each meeting, it is clear that the central question at issue in these meetings concerned the appropriate actions on the part of the Open Market Committee and the Federal Reserve System in the light of the economic situation and outlook as it was then known. If a complete, detailed record of the economic review presented to each meeting, and of the discussions of it, were available, greater differences of judgment on the economic situation and outlook might be revealed. However, it seems doubtful, at least for 1960, that such differences played a significant role in the determination of policy. If so, the public report is definitely inadequate. I would find it hard to believe that this was the case in view of the agreement in the text of these reports from the Open Market Committee meetings with the views expressed contemporaneously by various economists and organizations both inside and outside of Government circles.

It seems safe to suggest, therefore, that any appraisal of the Federal Reserve's performance in 1960, as revealed by the 1960 annual report should focus on whether or not sound judgment as to policy was exercised in the light of the economic information then available.

If the analysis of the economic situation was inadequate in any respect it would seem probable that it determine how much action by the Federal Reserve was needed to produce a given amount of desired results. Statements in the annual report indicate disappointment at the lack of results from its previous action. For example, on page 55 of the report concerning the meeting of May 24, 1960, there is a discussion of supplying reserves through open market operations so as to encourage an increase in the money supply, and the summary goes on to say "* * * which thus far had failed to respond to the easing steps taken by monetary policy." Why was it that the Open Market Committee and its staff did not find quickly the reasons for this lack of response? Why did they not take policy steps sufficiently vigorous to bring about the desired results? The System was moving in the right direction in line with the change in the economic situation, though not ahead of it—but why, all year, was its response in terms

of policy action so hesitant, so slow, so gradual? Once the decision was made that the situation called for a shift toward ease—which apparently occurred not later than May 24—why were not the instruments on policy pushed with sufficient vigor to bring about the desired rise in the active money supply?

(By Dr. Asher Achinstein of the Legislative Reference Service:)

THE 1960 ANNUAL REPORT OF THE FEDERAL RESERVE BOARD: A CRITICAL REVIEW [1] BY DR. ASHER ACHINSTEIN, LEGISLATIVE REFERENCE SERVICE

SCOPE OF THE INQUIRY

At the request of the staff of the Joint Economic Committee, this report examines the 1960 Annual Report of the Board of Governors of the Federal Reserve System from the following points of view:

1. How adequate is the information contained in the latest annual report to the Congress for understanding and evaluating the policies and operations of the Board, and especially the Open Market Committee?
2. How well did the Board and the Open Market Committee diagnose the changing economic situation, what policies were pursued, how were these policies implemented, and how timely and appropriate were the monetary actions taken?

THE RECORD OF POLICY ACTIONS OF THE OPEN MARKET COMMITTEE

In an important sense the Federal Open Market Committee is the principal policy-shaping body of the Federal Reserve System. Its 12 members, consisting of the 7 members of the Board of Governors and 5 Federal Reserve bank presidents, are not only concerned with setting policy for open market operations, but with the whole range of the System's monetary actions.

The Board is required by statute "to keep a complete record of the actions taken by the Board and by the Federal Open Market Committee upon all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying the action of the Board and the Committee in each instance * * *."

The only source of public information concerning the deliberations and decisions of the Open Market Committee is the annual report of the Board of Governors. The Federal Reserve Act provides that the Board shall include in its annual report to the Congress a full account of the actions taken by the Open Market Committee during the preceding year. To meet this requirement the annual reports contain entries with respect to the policy actions taken at each of the meetings, including the votes on the policy decisions and a résumé of the basis for the decisions as reflected by the minutes of the Committee.

The annual report's record of policy actions of the Open Market Committee, containing entries for each of the 17 meetings held last year, is concerned mainly with the policy directive which is to guide the manager of the open market account in executing transactions for the System. The entries for each meeting indicate some of the factors in the current and prospective business situation and the general credit conditions which are taken into account in arriving at a policy decision. The votes for and against the Committee's decision are recorded and some of the reasons given for action of members who dissent from the majority decision. Different shades of opinion are not infrequently recorded even for members who vote for the wording of a given directive. The manager of the System open market account attends the meetings of the Committee, and "the shades of opinion expressed at those meetings provide him with guides to be used in the conduct of open market operations, within the framework of the policy directive adopted by the Committee" (annual report, 1960, p. 34).

CHANGES IN POLICY DIRECTIVES IN 1960

Section (b) of the policy directive is supposedly the main guide to the manager in effecting transactions until the next meeting of the Committee. During 1960 there were five different versions of section (b).

The first version, which was in effect in January and February 1960, continued the directive originally adopted on May 26, 1959, and in force the remainder of the year. It called for operations with a view "to restraining in-

[1] Prepared by Asher Achinstein, senior specialist, Legislative Reference Service, at the request of the Joint Economic Committee in accordance with their specific instructions, May 1, 1961.

flationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities." From March 1 to May 24, 1960, the directive was changed to read that open market operations were to be conducted with a view "to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion." From May 24 to August 16 the policy was changed "to fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion." From August 16 to October 25, the directive was revised to provide that transactions should be undertaken with a view "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment." And from October 25 to the end of the year the previous directive was amended by adding the words "while taking into consideration current international developments."

The successive changes in the language of the directive may for the most part be said to represent policies which moved progressively in the direction of somewhat greater monetary ease. From "restraining inflationary credit expansion" during the first 2 months of the year, the directive during the next 3 months called for "fostering sustainable growth in economic activity while guarding against excessive credit expansion." From the end of May to mid-August the policy was that of "providing reserves for moderate bank credit expansion" followed in the next 10 weeks by a policy of "encouraging monetary expansion," and during the final 10 weeks of the year the aim of encouraging monetary expansion was qualified by adding the phrase "while taking into consideration current international developments."

THE HIATUS BETWEEN FORMULATION OF POLICY AND OPERATIONS

When the directives change from "restraining inflationary pressures" to "guarding against inflationary pressures," to "providing reserves for moderate bank credit expansion," and to "encouraging monetary expansion," one is puzzled as to how the management of the account is supposed to translate the revised policy statement into open market purchases and sales that are administered so as to affect bank reserve positions, and therefore, the flow of bank credit and money. Presumably, the official minutes of the meetings of the Open Market Committee contain the full range of instructions given to the manager of the System open market account. But from the résumé of these meetings in the Board's annual report one can hardly get any clues as to what these might be. If one turns to other publications of the Federal Reserve, such as "The Federal Reserve System," published in various editions by the Board of Governors, or Robert V. Roosa's "Federal Reserve Operations in the Money and Government Securities Markets," published by the Federal Reserve Bank of New York, one finds that they contain descriptions of how open market operations are conducted, but they throw little if any light on how the general directives actually serve as guides to the manager of the System account.

All that one can infer from the policy directives in 1960 is that the Committee sought to have open market operations move in the direction of less restraint. But the degree of relaxation intended by the various versions of the directive is shrouded in mystery because, standing by themselves, the revisions in language appear to have very little operational meaning. Without additional information concerning the specific instructions given to the manager of the account, an outsider can neither judge the degree of change intended by a revision of the directive, nor the extent to which the manager implemented the intended change in policy.

Not only do the directives lack operational meaning when the specific criteria for indicating the degree of relaxation or restraint intended is not furnished, but the summaries of the different viewpoints expressed at the meetings also suffer from the same deficiency. What one does gather from the discussion is that some of the members desired less restraint sooner than the majority. But the extent or range of their differences is not very clear. Suffice it to refer to the entries of the first few Committee meetings.

At the very first meeting of 1960 (January 12), when the Committee voted to continue the policy of "restraining inflationary credit expansion," the résumé states that "there was some sentiment for a slight lessening in the degree of restraint within the framework of the existing policy on the grounds that some moderate growth in the country's money supply should be encouraged in order to support the anticipated business expansion and to avoid excessive upward

pressure on interest rates." On the other hand, "one or two of those present leaned slightly in the direction of a firmer degree of restraint than had prevailed recently." Only one member, Governor Mills, voted against the continuation of the existing policy directive and its implementation since "he did not think it allowed sufficient leeway for the volume of new credit that would foster an appropriate growth of the money supply." Ever since the beginning of November 1959 he had argued for a policy that would lessen the degree of restraint on monetary expansion and had urged revising the directive to provide for "fostering sustainable economic growth while guarding against inflationary credit expansion." It was not until the March 1 meeting that the majority came around to his view.

At the February 9 meeting the Committee considered Mills' proposed modification of the existing directive. "There were several within the group who leaned toward slightly less restraint, and the views of some members of the Committee were more positively in that direction." But the majority "did not favor a change at this time, on the grounds that it would indicate a basic shift in open market policy and that such a shift was not called for at present." It is indeed a very strange reason for not changing a directive since every revision is presumably intended to express a shift in policy. But for the present purpose it is more important to note that the Committee regarded the adoption of Mills' version as representing a basic policy change. In what sense it was "basic," however, we are not told. Three weeks later the Committee did not hesitate to make the "basic" shift. Here again, in the absence of information indicating some order of magnitude, such as the additional amount of open market purchases the manager is expected to make to strengthen the reserve position of the banks, one is in no position to judge to what extent the members differed, or, for that matter, how the Committee intended to meet its responsibilities in the light of the changing conditions in general business and in the money market.

SOME LIMITATIONS OF THE TEXT OF THE ANNUAL REPORT

When one turns from the résumé of the policy actions of the Open Market Committee to the text of the annual report for additional light on monetary policy actions in 1960, one is also confronted by the need for additional information. The Federal Reserve System has at its command a more comprehensive system of statistical reporting on its operations than any other central banking system in the world. And yet, one would hardly gather that this was the case from an examination in particular of that part of the report headed "Monetary Policy and Bank Reserves." Since Federal Reserve officials consider that one of the most important objectives of open market operations is to promote economic stability by offsetting inflatinary and deflatinary developments in the economy through contracting of expanding commercial bank reserves, one would expect that the text would make every effort to provide a sufficient amount of pertinent data and interpretative materials so that, in retrospect at least, the Congress would be in a better position to evaluate how the System carried out its responsibilities during the course of the year.

The 1960 report devotes about three pages of text and two pages of digest to a review of monetary actions; a review which is done with a rather broad descriptive brush, and which therefore omits some highly pertinent information for evaluation purposes. The section includes one statistical table showing changes in member bank reserves for December 1960 and December 1959. Surely, for the purpose of judging the appropriateness and the timely flexibility of monetary actions, monthly data rather than yearend summations of the factors affecting bank reserves would be more helpful for understanding the role played by the Federal Reserve during a given period in influencing the supply of bank reserves which the banking system can use as a basis of monetary expansion or contraction. At the end of the annual report there are two tables, one on open market transactions (table 5) and the other on member bank reserves and reserve bank credit (table 17), which furnish monthly statistics for 1960. But when they are buried with other tables at the end of the report, and without a much-needed interpretative text, such light which they might throw on the role of open market operations during the changing business situation of 1960 is largely lost.

APPRAISAL OF THE CURRENT ECONOMIC SITUATION AND TIMING OF MONETARY ACTION

In its appraisal of the current business situation, the Open Market Committee noted that by the spring the inflationary psychology which was manifested at the beginning of the year had definitely diminished, important sectors of the economy were showing increasing signs of weakness, and economic developments pointed to a moderate rather than a boom pace of expansion. By midyear the Committee saw little upward momentum in business activity and increasing uncertainty in the business outlook. By September the Committee was of the opinion that while general economic activity continued sideways at a relatively high level there was increasing likelihood of a downward drift, and by November it was agreed that the economy was experiencing a business recession, although a relatively mild one.

In contrast to the 1957–58 business recession when the Federal Reserve continued its tight money policy for months after the downturn in general business activity had begun, the timing of monetary policy in the 1960 recession corresponded more closely to the changing business situation. The shift toward greater ease began in the spring when expansion in general activity had about reached its peak. By April the System began to increase its holdings of U.S. Government securities, thereby supplying the banks with a moderate increase in reserves. In June Federal Reserve discount rates were reduced from 4 to 3½ percent and in late August and early September they were lowered to 3 percent. In July margin requirements on credit used for purchasing or carrying stock market securities were reduced from 90 to 70 percent. In September reserve requirements against demand deposits for central reserve city banks were reduced from 18 to 17½ percent and in December from 17½ to 16½ percent. The most important source of additional reserves during the year was the Board of Governors' authorizations to member banks to count their vault cash as required reserves in the last week of August and the first week of September, and in the last week of November.

CRITICISMS OF MONETARY ACTION

While friendly critics of monetary policy may be pleased that in 1960 the Federal Reserve did a better job of timing than was the case in the summer and fall of 1957, they are of the view that the System should have pursued a more vigorous policy of ease in 1960, especially during the first half of the year. This criticism represents more than a matter of greater wisdom from the perspective of hindsight. It is based in part on the view that Federal Reserve stabilization philosophy of "leaning against the wind" has only too often in the past been applied only after a turn in general business activity was clearly recognizable. It is maintained that in view of the lags that occur between the adoption of a monetary policy and the variable time when it is likely to exert an influence upon the economy, changing to a policy of greater ease should begin when the pace of business expansion slackens and not wait until the Federal Reserve is practically certain that the peak of the business cycle has been reached. To be sure, such a less conservative approach to a shift in policy may involve greater risks, but it is argued that the Federal Reserve is in a good position through open market operations to modify its course more frequently as new evidence of a change in business trends becomes available.

Apart from this general type of criticism, there is the more specific criticism based on economic developments from mid-1959 to mid-1960, which point to Federal Reserve tight money policy as having contributed to the short-lived mid-1958–mid-1960 business expansion. Federal Reserve policy was so restrictive by mid-1959 that commercial bank borrowing at the Federal Reserve was maintained at a level of about $1 billion. The money supply stopped growing and demand deposits shrank by nearly $2 billion in the last half of 1959 and by another $2 billion in the first half of 1960. Meanwhile interest rates were climbing to their highest level in 30 years, with long-term rates rising more rapidly in the 1958–60 expansion than during any comparable stage of the business cycle in the last century. In January 1960 when short- and long-term interest rates reached their highest level, the Open Market Committee reduced its holdings of U.S. Government securities by a greater amount than at any time since the peak postwar reduction in January 1957. We have seen that there were some members of the Open Market Committee who favored an easier money policy in the latter part of 1959 and in early 1960, but their views did not prevail. In the absence of information not now available in adequate form in the annual report, it is difficult to judge the relative merits of the different views within the Open Market Committee.

THE POLITICAL STRUCTURE OF THE FEDERAL RESERVE SYSTEM

BY

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THE POLITICAL STRUCTURE OF THE FEDERAL RESERVE SYSTEM

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Public policy is not self-generating; it emerges from institutions. Foremost among the institutions charged with monetary and credit policy formation—an area, like fiscal policy, that has not received from political scientists the attention accorded to micro-economic regulation of particular firms or industries—is the Federal Reserve System. The purpose of this paper is to examine the "fit" of the System's formal structure to (1) the policy functions and the informal policy-forming mechanisms of the "Fed," and (2) the pattern of interests and values affected by monetary policy. Its thesis is that a substantial gap has developed between these elements.

A brief sketch of the formal structure of authority and the historical development of System functions is needed to begin with; this is followed by analysis of the formal and the effective roles of each component of the System along with the internalized interest representation at each level. Then the linkage between the Federal Reserve System and general economic policy is explored. Finally, the conclusion summarizes the findings and suggests briefly how formal structure and policy functions might be brought into closer, more effective alignment.

I. STRUCTURE AND FUNCTIONAL DEVELOPMENT

The Pyramid. The Federal Reserve System[1] can be described as a pyramid having a private base, a mixed middle level and a public apex. At the apex stands the Board of Governors (frequently referred to as the Federal Reserve Board or FRB). Its seven members are appointed by the President, with the consent of the Senate, for fourteen-year, over-lapping terms, one term expiring at the end of January in each even-numbered year. Members are removable for cause, but the removal power has not been exercised. In making appointments, the President must give due regard to "fair representation of financial, agricultural, industrial, and commercial interests, and geographical divisions of the country," and not more than one member can be appointed from a single Federal Reserve District. The Chairman is selected by the President for a renewable four-year term. The Board is independent of the appropriations process, for its operating funds come from semi-annual assessments upon the twelve Reserve Banks.

At a level of equivalent authority to the Board itself, but in the "middle" of the public-private pyramid, stands the statutory Federal Open Market Committee. It is composed of all FRB Members plus five of the twelve Reserve Bank Presidents, with the President of the New York Reserve Bank always one of the five and the others serving in rotation. The Chairman of the Board of Governors is, by custom, the Chairman of the Committee.

The Reserve Banks are quasi-public institutions: their capital stock is subscribed by the member banks—all national banks and about one-third of the state-chartered banks, at the statutory rate of six per cent (one-half paid in) of their capital and surplus—but their role is public as a part of the central banking system. While a six per cent cumulative dividend is paid to the member-bank stockholders, and a surplus equal to twice the paid-in capital has been accumulated, the remainder of the Reserve Banks' now sizeable earnings is surrendered to the national Treasury. The growth of the Banks as money-makers, especially in the past decade, is indicated in Table I;[2] their

[1] For more detailed description of the formal organization, see Board of Governors, *The Federal Reserve System* (Washington, D. C., 1961) and G. L. Bach, *Federal Reserve Policy-Making* (New York, 1950).

[2] The original Federal Reserve Act imposed a 90 per cent "franchise tax" on Reserve Bank earnings after expenses, dividends and an allowance for surplus. In the mid-1920s earnings were still a major concern, and the principal reason for the Banks' holding government securities, against the opposition of Secretary Mellon. In 1933 half the Banks' accumulated surplus was appropriated to furnish the initial capital of the new Federal Deposit Insurance Corporation; to allow the replenishment of surplus the franchise tax was dropped. By 1946 the surplus reached proportions that led the Board to decide as a matter of policy to pay 90 per cent of earnings to the Treasury, under the label of "interest" on outstanding Federal Reserve notes; this policy continued from 1947 through 1958. In 1959 the surplus was cut back to an amount equal to the subscribed (*i.e.*, twice the paid-in) capital, and the balance, together with all earnings after dividends, was paid over to the Treasury. *Annual Report of the Board of Governors*, 1959, pp. 96–99.

TABLE I. COMBINED RESERVE BANK NET EARNINGS, DIVIDENDS TO STOCKHOLDER BANKS, AND TRANSFERS TO U.S. TREASURY AND TO SURPLUS, SELECTED YEARS, 1914–1960. (THOUSANDS OF DOLLARS)

Year	Net Earnings	Dividends Paid	Paid to U.S. Treasury	Transferred to Surplus	% Dividends to Earnings
1916	2,751	1,743	—	—	63.4
1920	149,295	5,654	60,725	82,916	37.9
1922	16,498	6,307	10,851	−660	38.2
1925	9,449	6,916	59	2,474	73.2
1932	22,314	9,282	2,011	11,021	41.6
1935	9,438	8,505	298	635	90.1
1945	92,662	10,183	248	82,232	11.0
1950	231,561	13,083	196,629	21,849	5.6
1957	624,393	20,081	542,708	61,604	3.2
1959	839,771	22,722	910,650	−93,601	2.7
1960	949,000	24,500	897,000	42,000	2.6
Total 1914–1960	6,885,077	477,706	5,476,395	945,476	6.9

Source: *Annual Report of the Board of Governors, 1959*, pp. 116–117. Figures for 1960 approximate, from New York Times' Jan. 6, 1961, p. 35.

annual contribution to the Treasury currently amounts to about a tenth of the annual interest cost of carrying the public debt. In contrast with their paid-in capital of $387 million (as of December 31, 1959) their assets included some $27 billion in Treasury securities, and their earnings derived chiefly from the interest paid on these holdings.

The Reserve Bank Presidents are not government appointees; they are elected by the boards of directors of their respective Banks, subject to FRB veto; and their compensation—far above civil service levels—is fixed in the same way. Thus their selection is initially private, but with public supervision. The Board of Directors of each Reserve Bank consists of nine persons, six of whom are elected by the member commercial banks of that District (these banks, the "owners" of the Reserve Banks, constituting the private base of the pyramid), while three (including the Chairman and Deputy Chairman) are appointed by the FRB in Washington.

Off to the side stands the final element of statutory organization, the Federal Advisory Council (FAC). This group of twelve men is composed of one commercial-banker representative from each District, annually elected by the respective regional Boards. The FAC meets quarterly with the FRB to discuss general business conditions and may make recommendations to the Board on matters of policy. The twelve Reserve Bank Presidents constitute a non-statutory Conference of Presidents that meets three times a year; a Conference of Reserve Bank Chairmen meets annually with the FRB.

The Location of Policy Powers. The three major tools of monetary policy are the rediscount rate charged by Reserve Banks to member bank borrowers on their loans from the System; the setting of reserve requirement levels for the member banks; and—most important today—open market operations in securities of the federal government. Decisions regarding each of these instruments is formally located in a different organ of the System, although (as will be developed below) channels for advice and influence cause a mingling of the decisional powers in fact. The levels of reserve requirements are set by the FRB; open market policy is a function of the Open Market Committee (OMC), thus providing the regional and quasi-private elements of the System with formal access to the heart of monetary policy formation; and the Reserve Bank Boards of Directors share with the FRB formal authority over the discount rate. The rate is "established" every fourteen days by each regional Bank, but "subject to the review and determination" of the Board of Governors. In addition the FRB shares with the Comptroller of the Currency, the FDIC and state authorities a very considerable list of regulatory and supervisory powers over member banks and their officers.

Functional Change Since 1913. When established, the Federal Reserve System was thought of as exercising only the technical function of quasi-automatic adjustment of an elastic currency supply to the fluctuating needs of commerce and industry. The System was pictured as a "cooperative enterprise" among bankers for the purpose of increasing the security of banks and providing them with a reservoir of emergency resources.[3] To this day the Federal Reserve Act mandate reflects this view: it instructs that the discount rate and open market policy shall be operated with "a view of accommodating commerce and business," and that reserve requirements shall be handled so as to prevent "excessive use of credit for the purchase or carrying of securities." Nothing in the Act relates the monetary authority to the function of national economic stabilization; yet this is its prime task today.

In 1913, it was not foreseen that the techniques of monetary policy would become instruments of economic stabilization with their consequences for employment, growth and price stability overtaking their specific banking

[3] E. A. Goldenweiser, *American Monetary Policy* (New York, 1951), p. 295.

objectives in importance. Yet this is what has happened, beginning in the Twenties but more strongly and with more explicit recognition in the policy process since the Great Crash.[4] With this shift, the operation of the Federal Reserve System necessarily moved into the political mainstream, for the goal of stabilization requires making choices among alternatives that have important and visible consequences for substantial interests and community values. Once macro-economic policy had become the primary *raison d'être* of the System, the breadth of interests involved became coterminous with the nation, not just with the bankers; and monetary policy, as well as depositors' safety, became a public concern rather than a private convenience.

A corollary of the rise of stabilization to stage center is that the scope of FRB action has become essentially national, belying the assumption of relative regional independence that underlay the original legislation. Divergent policies for each region become undesirable—even impossible—if national stabilization is to be achieved in an increasingly interdependent national economy.

II. ROLES AND INTERESTS OF THE COMPONENTS

We turn now to a comparison of formal roles and interest composition with the informal roles and interest-impact of each level of the System's structure.

The Commercial Bank Base. The formal role of the member banks is that of an electoral constituency in the selection of six of the nine directors for each Reserve Bank. While the member banks have no direct policy voice, this electoral role originally gave them an indirect one, on the assumption that the regional boards would be policy-making bodies through their authority over the discount rate. That authority is negligible today. Furthermore, the "ownership" of the Reserve Banks by the commercial banks is symbolic; they do not exercise the proprietary control associated with the concept of ownership nor share, beyond the statutory dividend, in Reserve Bank "profits." As in the large, publicly held corporation, ownership and control have been divorced. No doubt the FRB, for example in the adjustment of reserve requirements, has been solicitous for the maintenance and improvement of commercial bank earnings. But if the record of the other "independent" regulatory commissions is any guide, this would have been true regardless of their stockholdings in the Reserve Banks.

Bank ownership and election at the base are therefore devoid of substantive significance, despite the superficial appearance of private bank control that the formal arrangement creates.

Reserve Bank Boards of Directors. The Reserve Bank Boards' authority to set rediscount rates, subject to "review and determination" by the FRB, is considerably diminished by the ultimate formal authority of the latter, for "determination" includes final decision and even initiation of rate changes. It is further reduced by informal practice: to avoid the embarrassments of public disputes, discount rate policy is discussed at OMC meetings and the determinations settled upon therein are usually followed through uniformly at the next meetings of the respective regional Boards of Directors.[5] The special formalities are "of little significance; rediscount policy is made in much the same way and on essentially the same considerations as is reserve and open-market policy."[6] The nationalization of function has thus removed the basis for the assumption of regional autonomy that underlay the original grant of authority to the Reserve Banks. The major tasks of the Directors now are to provide information on regional conditions for OMC and the FRB to take into account, and

[4] In the mid-1920s it dawned on the Reserve Banks—sooner than on the Treasury or the FRB—that open market purchases, first undertaken to improve Reserve Bank earnings, could be managed to offset declines in member banks' outstanding loans; see L. V. Chandler, *Benjamin Strong, Central Banker* (Washington, Brookings, 1958). The Banking Act of 1935, reorganizing the FRB and the System, ratified emergency improvisations in 1932–33 to restore bank liquidity by enabling advances to be made to member banks on the security of any of their assets deemed acceptable, and not just on "eligible" commercial paper as before. Federal deposit insurance was introduced in 1934, in recognition of the fact that more public policy objectives than the rescue of depositors in failing banks were at stake in the maintenance of confidence in the safety of bank deposits The architects of the 1913 act supposed they had, by and large, provided for the safety of deposits by establishing the rediscount privilege and strengthening bank examination powers.

[5] Joint (Patman) Committee on the Economic Report, *Monetary Policy and the Management of the Public Debt, Replies to Questions*, Sen. Doc. 123, 82d Cong. 2d sess., 1952, pp. 278–79. Cited hereafter as Sen. Doc. 123.

[6] Bach, pp. 81–82.

to serve as a communications and public relations link between the System and local communities—both the general community and the specific "communities" of commercial banking, industry, merchants and other financial institutions. They do not exercise important substantive authority.

This may be fortunate in view of the structure of interests that prevails at this level. For the range of interests, reflecting the banker-business orientation of 1913, is narrow by legal specification and narrower still in fact. By statute, each regional Board has three classes of membership: Class A consists of three commercial bankers; Class B of three men active in commerce, agriculture or "some other industrial pursuit"; and Class C, without occupational restriction. Class C members are appointed by the FRB; the others are elected by the member banks of each region.

Class A directors are elected by a method that groups the member-bank stockholders into size categories for voting purposes and assures the selection of one director from a large bank, one from a middle-sized bank and one from a small bank within the District. Informally, Classes B and C tend to be quite similar. Both are dominated by executives of manufacturing firms, utilities, oil and chemical firms, and large distributors—although Class C also includes an occasional academic economist or publisher. Very large firms predominate; very small firms, "family farmers," and labor are not represented. The list of Directors reads like a *Who's Who* of American industry.[7]

The propriety of excluding other segments of the economy from these Boards is not a substantively important question at present because of the decline in the Boards' authority, though the appearances could themselves become a political issue. But it is worth asking what functional value this elaborate structure possesses and whether the Boards would be missed if they were simply abandoned. The informational role of the Directors could be as well—perhaps better—performed by the Reserve Bank Presidents, who are full-time officials in close daily contact with their districts.

The Reserve Bank Presidents. The Presidents, by virtue of the membership of five of their number on the OMC (and the participation of all twelve in OMC discussions) are more significantly related to the policy process than are their nominal superiors, the regional Boards.

Selection of the Presidents is by the respective Boards, but subject to FRB veto: initially private but finally public. Increasingly, they are men with substantial Reserve System experience. Two-thirds of the incumbents have had such experience; one-third have come to their posts from careers in commercial banking. Their daily contacts are with private bankers and one observer suggests that they have been "inclined to favor more cautious, mild policies that would be less disturbing to the normal courses of banking and the money markets" than has the FRB.[8] Yet another writer, granting a "commercial banker mentality" in the early days of the System, argues that a public, central banking view is coming to prevail as a majority come up through the System.[9] In one respect the Presidents have clearly differed from the FRB: in their support of a change urged by commercial bankers that would place authority for all monetary actions in the OMC —a change the FRB has opposed.

As a statutory minority on the OMC, the views of the Presidents cannot be controlling in themselves. In the apparently unlikely event of a split within the FRB segment of the Committee, however, a solid front by the five President-members would enable them to determine public policy. Since they are not appointed by the President, nor removable for policy differences with either the President or the FRB within their five-year terms, the present structure allows the possibility that policy with a highly-charged political potential may be made by men who lack even indirect accountability to the national public affected. Former FRB Chairman Marriner Eccles has pointed out the uniqueness of the arrangement in these words: "there is no other major governmental power entrusted to a Federal agency composed in part of representatives of the organizations which are the subject of regulation by that agency."[10]

The situation of the Reserve Presidents reverses that of the regional Boards: while the latter's structurally important place has been downgraded by loss of function, the former's structurally inferior position has been upgraded by increased authority.

The Board of Governors and the Board Chair-

[7] See, for example, the *Forty-Sixth Annual Report of the Board of Governors of the Federal Reserve System* (Washington, 1960), pp. 134–48, for the list of names and affiliations as of December 31, 1959.

[8] Bach, pp. 57–58.

[9] Goldenweiser, p. 296.

[10] Joint (Douglas) Committee on the Economic Report, *Hearings, Monetary, Credit and Fiscal Policies*, 81st Cong., 1st sess., 1949, p. 221.

man. The gap between formal and informal roles in the Federal Reserve is readily apparent at the FRB level. By statute, it controls by itself only one of the major monetary instruments, the setting of reserve requirements. In fact, it is in a position to, and does, exercise authority in varying degree over all three instruments of policy—and is popularly recognized as *the* monetary policy authority. Further, the effective voice within the Board is that of the Chairman, despite the formal equality of all seven Members—and this too is popularly recognized. William McChesney Martin's name may not be a household word, but it is far better known than those of his colleagues. Over the years, the Board has seldom contained, besides the Chairman, more than one or two members at a time whose stature commanded independent respect.

The Board has final authority over discount rates through its power to "review and determine" the decisions of the Reserve Directors. The Members of the FRB constitute a seven-to-five majority in the OMC and thus—barring defections—control the most important of monetary tools. In fact, decisions on all three instruments of policy are taken on the basis of discussion within OMC. Since 1955 the Committee has been used as a "forum, a clearinghouse for all of the aspects of policy determination in the System."[11] Thus the formal distribution of authority is belied in practice by unified consideration. Unified control seems inevitable, since the types of decision are logically related and it would be unthinkable to have them operating in contradictory directions. Because of the political importance of monetary policy, however, and the desirability of fiscal-monetary coordination, it is questionable whether a twelve-man, quasi-private body provides an adequate or appropriate locus for policy determination; of this, more presently.

The size, length of term and interest composition of the FRB have been the subject of considerable Congressional attention and have undergone some change over the years. The Board began with five appointed Members with staggered ten-year terms and two *ex officio*—the secretary of the Treasury and the Comptroller of the Currency. Both the latter were removed in the 1935 revision of the Banking Act, at the insistence of Senator Carter Glass, then chairman of the Banking and Currency Committee. Now there are seven Presidential appointees, and the term is fourteen years. No Member, incidentally, has yet served a full fourteen-year term, but a few have served *more than* fourteen years through successive appointments to unexpired terms.

The Chairman is selected by the President for a four-year, renewable term. This definite term was adopted in 1935, apparently with the intent that an incoming President should have a free hand. Resignations and new appointments have not coincided with presidential inaugurations, however, with the result that the incumbent's appointment, for example, expires in 1963.

The Federal Reserve Act has from the beginning stipulated group-interest qualifications for FRB Members. Originally, two had to be experienced in banking or finance, and the total membership had to provide "fair representation" of industrial, commercial and financial interests—as well as a regional balance designed to avoid eastern "domination." In 1922 the requirement of financial experience was dropped and agriculture was added to the list of represented interests. The actual composition for the 1914–50 period was as follows: thirteen from banking, five each from business and agriculture, and four from law.[12] Those appointed since 1950 have included one from private banking, two from business, two from agriculture and one each from the deanship of a business school and from a government career. Two of the post-1950 group also had experience of several years each on a Reserve Bank Board and one appointee's major experience had been as a Reserve Bank officer. "Promotion from within" is the trend. Among the major organized interests, labor is conspicuous by its absence. Business has been represented, but by substantial independents (ranchers, lumbermen, realtors) rather than by executives of large industrial corporations.

The size, length of term, interest composition and geographic distribution are all of questionable value to the System's policy functions and administrative effectiveness. It has been argued that fourteen-year terms provide an opportunity for Members to develop a knowledge of monetary economics and that they insulate the Board from partisan considerations. But many posts of equal technical complexity in other agencies are adequately staffed on a much shorter basis and, more importantly, insulation from politics is as impossible as it is democratically undesirable for an agency functioning so near the center of

[11] Chairman Martin in Senate Committee on Finance, *Hearings, Investigation of the Financial Condition of the United States*, 85th Cong., 1st sess., 1957, p. 1260. Cited hereafter as Senate Finance Committee *Hearings*.

[12] Bach, p. 119.

national economic policy. I shall return to this point later.

Although replacement of the Board by a single executive has been suggested only rarely, many observers, including Chairman Martin, are on record as favoring a smaller group than seven, on the ground that more capable men might then be attracted to the Board.[13] Clearly a seven-man board cannot collectively negotiate effectively with the President, the Secretary of the Treasury, the Chairman of the Council of Economic Advisers, or the lending agencies whose programs impinge on economic stability; yet coherent policy requires negotiation, consultation and program coordination constantly. Nor would a five-man board be notably better in this respect.

As it is now, the Chairman *is* the Federal Reserve Board for purposes of negotiation. In recent years he has lunched with the Secretary of the Treasury weekly,[14] and has sat in with the President's informal inner council on economic policy.[15] Congressional committees rely upon the Chairman to speak for the Board and rarely bother to interrogate other Board members. These arrangements apparently work because none of the other members is strong enough, personally or politically, to challenge the Chairman; and also, it seems reasonable to suggest, because there is no alternative save chaos. It is supported too by the tradition of secrecy that attends the actions of central banks, and that is defended as necessary to prevent the exploitation of leaks to private advantage: the fewer the negotiators, the less the likelihood of leaks. The gap between formal structure and the necessities of action reflected in the informal but decisive accretion of power to the Chairman (not only to the incumbent, but to McCabe and Eccles before him) is too great to be bridged by a minor adjustment in the size of the group.

Because of the importance of the Chairmanship, and the necessity for cordial relations between the head of the FRB and the President, Martin and McCabe have both suggested that the four-year term of the Chairman should end on March 31 of the year in which a President begins his term of office. Simpler still is the suggestion that the Chairman's term should be at the President's pleasure, as with most other national regulatory commissions. Whichever way the matter is handled, the need is for a relationship of mutual trust between President and Chairman, both for the sake of consistent economic policy and for democratic accountability through the President as chief elected representative of the public.[16] The present system of a fixed four-year term that (accidentally) does not coincide with Presidential inaugurations is unfortunate on both counts. Moreover, since the staggered 14-year terms of members expire in January of even-numbered years, a new President—even if the Chairman stepped aside—would be confined to the membership he inherits, in choosing a new Chairman, unless some member resigned to create a vacancy.

The policy suitability of geographic and interest qualifications for membership on the Board is a question that would become moot if the Board were replaced by a single head. If not, the answer must be that such qualifications are unsuitable because they are irrelevant and, in their present form, inequitable as well. They are irrelevant because the function of the Board is no longer simply to accommodate business, but to stabilize the national economy. The Board is not engaged in mediating group conflicts where the direct representation of parties-in-interest may be an irresistible political demand, but in a task of economic analysis and political judgment affecting the interests and values of *all* groups and individuals. Given the agency's function, independence of mind and familiarity with government finance and money markets, and with macro-economic analysis, are far more desirable qualifications than group representation.[17] Sensitivity to basic political currents—a quite different kind of "expertise"—is also pertinent, but not sensitivity only to the needs of a few special segments of the economy. The geographic qualification is equally irrelevant because of the nationalization of economic forces; five of the twelve districts must go unrepresented at any given time, as it is. And some geographic spread would be secured in any event, although without the severely restrictive effects of the current requirement upon the availability of capable men, simply because Presidential politics would work in this direction in the FRB as it does in cabinet and Supreme Court appointments.

The inequity of existing group representation requirements lies in the exclusion of interests as much affected by monetary policy as those that are included by statute. The present

[13] Sen. Doc. 123, p. 30.

[14] Senate Finance Committee *Hearings*, 1959, p. 2180.

[15] Conversation with staff members, Council of Economic Advisers.

[16] Bach, pp. 227–28.

[17] See Chairman Martin's remarks, Sen. Doc. 123, p. 300, and Bach, p. 121.

range reflects the original, restricted concept of the System. Today if groups are to be represented as such labor has as strong a claim as the farmers or industrialists, because employment levels are dependent on monetary policy to a significant extent; fixed-income receivers, whether corporate bond-clippers or Social Security pensioners, are directly and adversely affected if the tools of the FRB are not used with sufficient vigor to combat inflationary tendencies. Chairman Martin has even defined the objectives of monetary policy as providing job opportunities for wage earners and protection of those who depend upon savings or fixed incomes.[18]

One political consequence of the existing interest exclusions is to lessen the acceptability of monetary policies in the eyes of organized labor—or, at least, in the eyes of its leadership. The AFL-CIO Executive Council launched an attack in February, 1959, on banker and corporate-executive "domination" of the Fed, drawing a direct connection between the pattern of representation at both national and regional levels and what it called "misguided anti-inflation measures" that stifle growth while increasing bank profits.[19] As we have seen, the regional Boards lack the power to determine policy independently and the labor complaint is misdirected to that extent. Yet the *appearance* of the System may be as important as the substance in determining reactions to policy, and the appearance leaves the System open to this type of charge. As regards the national Board, the charge *could* have relevance: a labor representative might be more hesitant than other members in espousing "hard" policies that could dampen employment; but it is equally possible that he would in time adopt the coloration of his surroundings, which in the case of the Federal Reserve would apparently mean an institutional bias for "sound money" and a priority for anti-inflation goals.

Even if labor and pensioner representation were added, however, the list of affected interests would be far from exhausted. As Emmette Redford has written of interest representation in regulatory agencies generally, "It is difficult, if not impossible, to include representation of all the interests which might legitimately make a claim for some representation."[20] A non-interest or "general interest" criterion for appointments would be the simplest way to avoid the problem entirely if a multi-member Board is retained. A statement expressing the views of the House Committee on Banking and Currency in 1935 sums up the matter nicely:

> It is important to emphasize in the law that Board action should reflect, not the opinion of a a majority of special interests, but rather the well considered judgment of a body that takes into consideration all phases of the national economic life.[21]

The Open Market Committee and Policy Unification. In origin and development, the OMC represents the leading structural response of the Federal Reserve System to its change in function. But the response has not been entirely adequate and further modifications in the structure and scope of authority of the Committee have been advanced from a number of quarters.

When the System began operations, the discount rate and the levels of reserves were thought to be the major tools of policy. As the public debt grew, and as the macro-economic function of stabilization developed, open market operations by the Reserve Banks increased in importance. The initial structural response came in 1922 when an Open Market Committee was established informally, more under the leadership of President Benjamin Strong of the New York Reserve Bank than of the FRB. The Banking Act of 1933 gave the OMC statutory recognition as a twelve-man group, selected by the Reserve Banks, to carry on open market operations under rules laid down by the FRB, thus substantially increasing the power of the national, public component. The Banking Act of 1935, largely written by then-Chairman Eccles as an effort to enhance the centralized, public character of the monetary authority, reorganized the Committee into its present form: the seven FRB members and five Reserve Presidents.[22] (The House version—not enacted—of the 1935 Act would have gone further with the centralizing process by transferring authority for open market operations to the Board alone, with a requirement of consultation with an advisory committee of the regional Banks.)

[18] Senate Finance Committee *Hearings*, p. 1262.

[19] Statement (mimeograph) of the AFL-CIO Executive Council on *Monetary Policy* San Juan, Puerto Rico, February 24, 1959. See also, *New York Times*, February 26, 1959, p. 30, and March 6, 1959, p. 24.

[20] *Administration of National Economic Control* (New York, 1952), p. 270; and see ch. 9 generally.

[21] House Report No. 742, 74th Cong., 1st sess. (April 19, 1935), p. 6.

[22] Marriner S. Eccles, *Beckoning Frontiers* (New York, 1951), pp. 167–71. These pages contain an excellent capsule summary of OMC development.

In short, change in economic circumstance, *i.e.*, the growth of a large federal debt as an inescapable component of the nation's financial structure, and the development of a new function led to an institutional addition to the System. Informally, the change has gone one step further: as mentioned earlier, the OMC is used as a forum for discussion of the entire range of monetary actions, not just for decisions regarding the tool that lies formally within its jurisdiction.

There is widespread agreement among participants and observers that unified handling of the three major techniques is essential for coherence; but there is sharp disagreement over the appropriate composition of the OMC and over the division of labor between OMC and FRB. The disagreements involve in a politically sensitive way the central-regional and public-private balances in the policy process. The range of specific proposals is as follows:

(1) Consolidate all instruments in a publicly appointed Board, either the present FRB or a smaller one, abolishing the OMC but requiring consultation with the Reserve Bank Presidents. Variants of this have been suggested by the Hoover Commission Task Force, Eccles, and Bach, who see this approach as the proper way to secure the advantages of both public responsibility and "grass roots" information.[23]

(2) Consolidate by merging the OMC and FRB into a single Board constituted of three Members appointed by the President and two Reserve Bank Presidents, each of the latter group serving full time for a year on a rotating basis. This was proposed by former Chairman McCabe in 1949 as the proper change if any were to be made at all;[24] it would have the effect of displacing the New York Bank President from his present permanent seat on the OMC.

(3) Consolidate in the OMC as presently constituted. This is the position once favored by the regional Presidents.[25]

(4) Consolidate reserve requirements and open market policy in a reconstituted OMC consisting of the present five Reserve Bank representatives and a smaller FRB of five Members—thus creating an even balance between central and regional, publicly and semi-privately appointed elements. This proposal was advanced by the New York Clearing House Association, which also urged that in case of a disagreement between a Reserve Bank and the FRB over the rediscount rate, either party should be allowed to refer the question to the OMC for final decision.[26] The Association apparently felt that commercial bank influence was greater with the Presidents than with the national Board.

Those preferring no change at all include Martin, who has defended the existing arrangement as consistent with the "basic concept of a regional" System and as a way of promoting close relations between the Presidents and the Board.[27] The Patman subcommittee saw no reason, as of 1952, to disturb the *status quo*, but Representative Patman has more recently proposed consolidation in an enlarged FRB of twelve Presidential appointees.[28]

The rationale underlying the all-powers-to-the-Board approach can be summarized in the principle that public functions should be lodged in public bodies, and the assertion that open market operations are in no sense regional in character. Eccles has pointed out that the Reserve Presidents are not appointed by or accountable to either the President or Congress, and for this reason argues that their participation in national, public policy formation is inappropriate.[29] Bach has emphasized the national character of open market policy,[30] and he is joined in this view by Jacob Viner, who has said that:

> The regional emphasis in central banking is an obsolete relic of the past. No country, not even Canada, which is much more a collection of dis-

[23] Commission on Organization of the Executive Branch of the Government, *Task Force Report on Regulatory Commissions*, Appendix N, January, 1949, pp. 113–14; Eccles, pp. 224–26; Bach, pp. 234–35.

[24] Joint Committee on the Economic Report, *Monetary, Credit, and Fiscal Policies, A Collection of Statements*, 81st Cong., 1st sess., 1949, pp. 68–69.

[25] *Ibid.*, p. 162. By 1952, the Presidents were less enthusiastic for change (see Sen. Doc 123, p. 673). They perhaps feared that the unified control might go to the FRB rather than to the OMC if the subject were opened up at all.

[26] New York Clearing House Association, *The Federal Reserve Reexamined* (New York, 1953), pp. 138–39.

[27] Sen. Doc. 123, p. 294.

[28] Subcommittee on General Credit Control and Debt Management, Joint Committee on the Economic Report, *Monetary Policy and the Management of the Public Debt*, Sen. Doc. 163, 82d Cong., 2d sess. (1952), p. 54; H. R. 2790, 86th Cong., 1st sess. (1959).

[29] Joint Committee on the Economic Report, *Hearings, Monetary, Credit and Fiscal Policies*, 81st Cong., 1st sess. (1949), p. 221.

[30] Bach, p. 234.

tinct economic regions than is the United States, has thought it expedient to follow our initial example of introducing regionalism into central banking.[31]

The argument for OMC as the top body derives from the importance attributed to regionalism and (inferentially at least) from a belief in the financial community that the Committee is more sympathetic than the FRB to the felt needs of bankers. The regional case has been most strongly stated by President Delos C. Johns of the St. Louis Reserve Bank:

Each Reserve bank president is in a position to judge possible alternatives of national monetary policy with due regard to the particular characteristics of his region. This makes for adoption of national monetary policy that squares realistically with actual conditions in the regions. . . .[32]

Macro-stabilization as the major function of the System clearly forecloses regional devolution in the making of policy, yet regional circumstances should be considered. The valid claims of regionalism, however, require only a consultative voice, not a decisional one. And public policy, I would agree with Eccles, should not be made by a body containing men who are not accountable to the national public whose welfare is affected by the decisions made.

In *operations*, as distinct from policy determination, regionalism may well possess continued utility; and centralization of policy is entirely compatible with a considerable degree of regional diversification in operations. The point of greatest overlap between national policy and Reserve Bank operations appears to be in the handling of the "discount window," that is, the ease or difficulty with which a member bank may avail itself of the rediscount privilege. A uniform national policy could, for example, suggest "easier" loan conditions in any District whose area rate of unemployment was "x" percentage points above the national average, and thus provide for regional differentiation while maintaining central policy control.

Federal Advisory Council. The Federal Advisory Council began as a compensation to the commercial bankers for their failure to obtain direct representation on the FRB.[33] Its function today has been described as providing "firsthand advice and counsel from people who are closely in touch with the banking activities of their particular districts,"[34] although available information does not explain how these bank representatives are able to contribute something that the Reserve Bank Presidents, with their extensive staff aids, could not supply as well or better. Assuming that their advice is not redundant, however, it is questionable whether the FRB should accord *statutory* advisory status to commercial bankers only, now that the System's policy may affect many other social groups just as significantly as the bankers; *e.g.*, non-bank financial institutions, home builders, state and local governments, Golden Age Clubs, wage-earners, and so on. The Board has at times used formal consultants from outside the commercial banking sphere, as when consumer credit regulations were being formulated;[35] but this is apparently infrequent. Once again, we see that the System's structure has become outmoded by the change in scope of function.

III. THE FEDERAL RESERVE AND NATIONAL ECONOMIC POLICY

The analysis to this point has focused upon internal factors. We come now to the questions: What is the source of the Federal Reserve's policy goals? Does existing structure adequately relate the monetary authority to the President and to the monetary management operations of the Treasury, to lending agency decisions, and to the Council of Economic Advisers? Does an adequate mechanism exist for resolving disputes that threaten the coherence of an Administration's over-all economic policy? These can only be answered by going beyond the internal organization of the Fed to a consideration of its external relationships.

The first place to look for the mandate of an agency is in its organic statute; but the Federal Reserve Act deals sparsely with the matter of goals, and has in any case, as already noted, been outpaced by events. Since the law

[31] Subcommittee on General Credit Control and Debt Management, Joint Committee on the Economic Report, *Hearings, Monetary Policy and the Management of the Public Debt*, 82d Cong., 2d sess. (1952), p. 756, cited hereafter as General Credit Control Subcommittee *Hearings*, 1952. Regionalism in the Federal Reserve—or at least its modern defense—perhaps owes more to an unexamined bias in favor of "federalism" as a matter of political ideology than to an empirical examination of the national economic structure.

[32] Sen. Doc. 123, pp. 677–79.

[33] Robert E. Cushman, *The Independent Regulatory Commissions* (New York, 1941), p. 160.

[34] Martin, in Senate Finance Committee *Hearings*, 1957, p. 1261.

[35] Letter, Kenneth A. Kenyon, Assistant Secretary, Board of Governors, to the author, August 17, 1960.

does not provide a mandate fitted to the modern concerns of the System,[36] it is to the Employment Act of 1946 that one must look for goals written in macro-economic language: "it is the continuing policy and responsibility of the Federal Government to use all practicable means . . . to promote maximum employment, production, and purchasing power." This declaration applies to the Federal Reserve as to all other agencies of the national government, and is often mentioned in FRB descriptions of the System's role. But as a policy guide it is less than complete. For one thing, it does not mention price stability, although it has been widely interpreted as including this goal by logical extrapolation from those explicitly specified. For another, it leaves open such questions as, should employment be maximized today by measures that may bring on unemployment tomorrow by over-stimulating a "boom," or conversely, contribute to unemployment today lest inflation come tomorrow?

Thus the Employment Act mandate shares the imprecision of most such statements. While it could perhaps be sharpened, a need for interpretive subsidiary definition probably cannot be eliminated because any language tight enough to do this would inevitably place too inflexible a straight-jacket on agency operation.[37] Elaboration of goals at later stages of the policy process may be expected to continue. The President, who enters office with a vague mandate that is partly personal, partly party doctrine, commonly sets at least the tone for the specific interpretation of statutory directives, by the nature of his appointees. But the President's authority over the Federal Reserve is restricted, unless vacancies occur, to one appointment of a member (for fourteen years) every other year starting a year after his own term begins; and to appointment of the Chairman for a fixed four-year term. The independence of the agency conflicts with the President's responsibilities for overall economic policy.

In support of the position that independence should prevail—*i.e.*, that the FRB should not take its mandate from the President—the argument is advanced that anti-inflationary measures are unpopular though necessary; that "hard" decisions are more acceptable "if they are decided by public officials who, like the members of the judiciary, are removed from immediate pressures";[38] and that the accountability of the System to the electorate is adequately achieved through its responsibility to Congress.[39] On the other side, the President is required by the Employment Act to submit a program for achieving the Act's goals; such a program must include recommendations on monetary policy to be meaningful; and thus the President must be "the coordinating agent for the whole national economic program."[40] Men on both sides agree on one point: there should be a strong advocate within the government for the monetary stability viewpoint, and the central bank is the logical home for such advocacy. The major disagreements are whether a substantial degree of insulation from other agencies engaged in economic policy determination helps or hinders the expression of that viewpoint, and whether a clear locus of authority is required for settlement of disputes between the institutions

[36] Had Eccles been successful in writing his ideas into the 1935 amendments to the Federal Reserve Act, the Act would have anticipated by eleven years the declaration of national economic policy adopted in the Employment Act. The Eccles mandate would have directed the FRB "to exercise such powers as it possesses in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment so far as may be possible within the scope of monetary and credit administration." H. Rept. No. 742, 74th Cong., 1st sess. (1935), p. 9.

[37] An attempt to clarify the Federal Reserve's role by means of a clearer mandate has been urged by Senator Paul Douglas and by Jacob Viner, see Sen. Doc. 163, p. 74; General Credit Control Subcommittee *Hearings*, 1952, pp. 771–72. It has been opposed by Goldenweiser and the Reserve Bank Presidents: *ibid.*, p. 765; Joint Committee on the Economic Report, *Monetary, Credit, and Fiscal Policies, A Collection of Statements*, 81st Cong., 1st sess. (1949), p. 101. The absence of any mandate legislation since the Employment Act suggests insufficient Congressional consensus upon its substantive content. Organized labor has opposed amendments to add price stability to the goals of that Act, as intended to water down its emphasis on "maximum employment."

[38] Martin, in Sen. Doc. 123, p. 242.

[39] See, for example, FRB Research Director Ralph A. Young's remarks, Antitrust Subcommittee, Senate Committee on the Judiciary, *Hearings, Administered Prices*, 86th Cong., 1st sess. (1959), Part 10, pp. 4887–91.

[40] See H. Christian Sonne's comments, from which the quotation is taken, in General Credit Control Subcommittee *Hearings*, 1952, pp. 848–50.

variously responsible for monetary and fiscal policies.

The issue of FRB accountability to Congress is a false one and should be exposed as such. Contrary to a myth strongly held by System spokesmen—and many Congressmen—the FRB, even more than the other regulatory commissions, is *less* accountable to Congress than are the line departments in the Presidential hierarchy. The Federal Reserve does not depend on appropriations and thus is freed from the most frequently used tool of Congressional administrative supervision. And Congress has exercised an unusual degree of restraint in even suggesting its policy views to the Board. All executive agencies that have statutory bases may be said to be "creatures of Congress," and those with single heads are more easily held accountable than those with boards that diffuse responsibility.[41] For agencies with substantive powers, the price of accountability to Congress is accountability to the President.

On the need for a coordinating authority, Martin's position has been to grant the need for coordination but to argue that it can be achieved adequately through informal consultation.[42] The Advisory Board on Economic Growth and Stability established by President Eisenhower in 1953 would appear to be in line with his thinking: ABEGS (under leadership of the then CEA Chairman Arthur Burns) could bring about full exchange of information and full discussion, but could not *commit* the participating agencies to a unified course, even before it fell into desuetude after Burns' departure. The same was true of the Treasury Secretary-FRB Chairman luncheons and the President's informal economic policy discussions with agency heads during the Eisenhower Administration. Thus the problem of a possible stalemate or contradiction between Presidential and FRB policy is not resolved by these consultative arrangements.[43] A stronger incentive toward reaching consensus would be provided by the Clark-Reuss bill.[44] This would make it the "sense of Congress" that the President's Economic Reports under the Employment Act should include "monetary and credit policies to the same extent as all other policies affecting employment, production and purchasing power," with provision for inclusion of an FRB dissent, if necessary, in the Reports.[45] But again, unity would not be assured and accountability would remain obscure. Only if the FRB Chairman served at the will of the President, and a centralized authority directed the use of all credit instruments, would a formal basis for cohesion and accountability be laid.

Would a proposal of this kind mean the subordination of monetary stability to a frequently assumed low-interest, easy money predilection in the Treasury Department and the White House? While an unambiguous "No" cannot be given in reply, the weight of argument is in the negative direction. Independence may mean isolation rather than strength, for independent agencies lack the power of Presidential protection and Presidential involvement. Paradoxically, the real ability of the Fed to influence national economic policy might very well be increased if its formal independence were diminished. Have not the informal steps taken in the past seven or eight years toward closer liaison between the FRB and Presidential policy makers already made the Board (*i.e.*, the Chairman) somewhat stronger than was the case during the Truman Administration?

In addition to Presidential elaboration of Congressional policy statements, further interpretation is invariably made at the agency level. When the FRB or OMC decides to change, or not to change, the degree of restraint or ease in credit policy it is deciding—*necessarily*—whether to place emphasis for the short-run on the price stability or the maximum-employment-and-growth side of its imprecise mandate. The question of internal interpretation, therefore, is whether the policy preferences of the monetary authority are likely to coincide with those of the politically accountable originators and interpreters of the mandate. The probability is that the central banking agency will be to some extent more conscious of the monetary than of the employment-and-growth aspects of stabilization, the major reasons being (1) the role of the institu-

[41] For discussion of this and other pertinent administrative myths, see Harold Stein's remarks in General Credit Control Subcommittee *Hearings*, 1952, pp. 758–59.

[42] Sen. Doc. 123, pp. 263–73.

[43] See the remarks of Leon H. Keyserling and Roy Blough in Sen. Doc. 123, pp. 848–51.

[44] Its most recent form, at the time of writing, was embodied in S. 2382, 86th Cong., 1st sess.

[45] For extended discussion of the Clark-Reuss proposal, see: Executive and Legislative Reorganization Subcommittee, House Government Operations Committee, *Hearings, Amending the Employment Act of 1946*, 86th Cong., 1st sess., 1959, and Subcommittee on Production and Stabilization, Senate Committee on Banking and Currency, *Hearings, Employment Act Amendments*, 86th Cong., 2d sess., 1960.

tion, (2) the inevitably close relationships of the policy makers to their commercial banking "clientele" as the focal point of immediate policy impact, and (3) the social backgrounds of the policy makers. The Administration (of whichever party) and Congress, however, are likely to give greater weight to employment than are the central bankers, simply because the political consequences of unemployment are likely to be—and are even more likely to be perceived as—more unfortunate for elected office holders than those of price inflation. This difference may be pronounced or slight, depending on the personal emphasis and understandings of the men involved; but that they will continue to exist even when the general orientation of both sides is similar was shown by the occasional disputes between the President's economic advisers and the FRB during the Eisenhower Administrations.[46]

The internal structure of authority affects FRB policy in one other respect pertinent to the mandate question. This is the absence of an instrument for dealing with what has come to be known as "administered price" or "market power" inflation; *i.e.*, inflation caused, not by excessive demand, but by the ability of unions and companies in situations of diminished competition to raise wages and prices even in periods of unutilized manpower or productive capacity. Such inflation can only be dealt with effectively by monetary or fiscal techniques if employment and growth are depressed beyond the political limits of public acceptability. A policy dilemma results. The Fed does not have (and probably does not want to have) authority to take direct action against this type of inflation. Nor, since the tools for such action would be non-monetary in nature,[47] is it appropriate that the central banking agency take on such a task. Yet in the absence of any but the traditional instruments the FRB is faced with a cruel choice: its own rationale calls for it to fight inflation, but doing so would create rising unemployment. If it refrains from acting, in order to preserve high employment, it may fail to stop inflation. Does it have a mandate to make such a choice? One could be extrapolated from the general stabilization directive, but not with any clear political sanction. As economist Gardiner C. Means has said, "there is a good deal of question whether such a momentous decision should rest with the Federal Reserve Board."[48]

IV. CONCLUSION

The basic finding of the analysis presented above is that the formal structure of the Federal Reserve System is inappropriate to its functions and out of line with informal arrangements that have the logic of necessity behind them. These gaps flow from changes in the monetary authority's function and in the structure of the economy. Devised as a service agency for banking and commerce—to achieve a semi-automatic adjustment of the money supply—the Federal Reserve has become as well a policy-making institution with major responsibility for national economic stabilization. Ancillary arrangements for interest representation based on an assumption that monetary actions were of important concern only to bankers and businessmen now have the appearance of unjustified special access because the range of affected interests and values is seen to be as broad as the nation itself.

Informal developments—most notably the unified handling of major monetary techniques and the preeminence of the Chairman's position —and the formal changes of 1935 that in a degree public-ized and nationalized the Open Market Committee did something to improve the fit of form to function. But these alterations have not been sufficient to ensure adequate accountability for what is today an authority of first rank political importance; they have not brought the quasi-private "face" of the System into line with its public responsibilities; and they do not provide a sufficient organizational base for coherent integration of the fiscal and monetary components of national economic policy. A more complete face-lifting is in order.

The Chairmanship is the key both to accountability and to effective performance. The four-year fixed term, having produced a result contradictory to the one intended, should be repealed in favor of service at the pleasure of the President. The informal preeminence of the Chairman should be recognized formally by abolishing the Board and the OMC and centralizing authority over the discount rate, reserve requirements and open market operations in the hands of the Chairman, who might be re-titled the Governor of the Federal Re-

[46] *E.g.*, in the spring of 1956; see discussion in Senate Finance Committee *Hearings*, 1957, pp. 1361–63.

[47] See Emmette S. Redford, *Potential Public Policies to Deal with Inflation Caused by Market Power*, Joint Economic Committee, Study Paper No. 10 for Study of Employment, Growth and Price Levels, 1959.

[48] Antitrust Subcommittee, Senate Committee on the Judiciary, *Hearings, Administered Prices*, 86th Cong., 1st sess. (1959), Part 10, p. 4917.

serve System. The need for information from below could be handled through regularized reporting from the Reserve Bank Presidents on regional conditions, and by strengthened staff analysis in the Office of the Governor. By these alterations, the public, *i.e.*, political, quality of monetary policy would be accorded appropriate recognition; responsibility would be clearly located; a means of settling possible disputes between fiscal policy under the President and monetary under the Fed would be created; and the process of consultation and negotiation by the Fed with the Treasury, the CEA and the lending agencies would be made more effective. In short, a single head, enjoying the confidence of the President, would be able to speak with vigor for the central banking viewpoint in the formation of economic policy; yet once the deliberations had been completed an assurance would exist that the Fed would be at one with the rest of the government in executing the policy determined upon.

A second, lesser category of structural change would have the object of revising the Fed's appearance to fit the public nature of its responsibilities. Election of two-thirds of the Reserve Bank Directors by commercial banks, and "ownership" of the Reserve Banks by commercial banks, are admittedly matters of no great substantive importance today. But since they are functionless elements, and their appearance of special interest access is harmful to the legitimacy of monetary actions, the Reserve Boards should be eliminated (or, at least, all of their members should be publicly appointed) and the commercial banks' shares in the Reserve Banks should be bought out by the government—thus making the Reserve Banks in form what they largely are in fact: field offices of the national, public monetary authority.

Adoption of this series of proposals—or others, perhaps milder in form but having the same essential consequences—would significantly improve the economic policy machinery of the national government. These changes represent a logical extension of the premises of the Employment Act:

> In no major country of the world today, except in the United States, is there a central bank that can legally, if it wishes, tell the head of its own Government to go fly a kite. It seems to me that if we are to hold Government responsible for carrying out the new doctrine of economic stabilization, there must be a chain of responsibility reaching through the Presidency to all the instrumentalities that do the stabilizing.[49]

[49] Elliott V. Bell, "Who Should Manage Our Managed Money?" An address before the American Bankers Association Convention, Los Angeles, California, October 22, 1956.

Chairman PATMAN. You can take your time in answering these questions, but we would like to have them back with the transcript, if you please.

Mr. MARTIN. Thank you.

Chairman PATMAN. I think, without objection, we will put those in the record, and I will not ask any more questions at this time.

(The questions and answers referred to follow:)

"1. In framing its directive to the manager of the account and reporting to the Congress, what, if any, difference is there in the terms 'credit expansion' as in the revision of May 24, and 'monetary expansion' as in the revision of August 16? Are we to understand these terms to apply to an expansion of total loans and investments, of demand deposits, of demand deposits plus time deposits, or currency in circulation plus demand deposits?"

No difference was meant by the two terms "bank credit expansion" as used in the May 24 revision of the Federal Open Market Committee's policy directive, and "montary expansion" as used in the August 16 revision.

The term "bank credit expansion" refers more precisely to an increase in the total loans and investments of commercial banks, that is, in their principal assets. "Monetary expansion" relates to an increase in the Nation's money supply, usually defined to include demand deposits of banks and currency in circulation. Technically speaking, the terms differ in that "bank credit expansion" approaches the problem from the bank asset side, while "monetary expansion" approaches it from the bank liability side. Since demand deposits are at the same time the major component of the money supply and the main, although not the sole, offsetting liability to bank assets, bank credit expansion and monetary expansion are essentially two sides of the same coin.

"2. What is the reason for including the limitation in various directives restricting changes in security holdings of the System to $1 billion or later to $1.5 billion: Have these limitations at any time during the past year restricted or controlled the actions taken?"

The dollar limitation contained in the directive issued to the Federal Reserve Bank of New York by the Federal Open Market Committee is intended simply to set a ceiling on the total change that may be made between meetings in System account holdings of Government securities without further consideration by the Committee. The limitation did not preclude operations in pursuit of the Committee's policy objectives at any time during the past year.

The usual limitation of $1 billion is high enough to cover any normal variations in the System portfolio required over the usual 3-week period between meetings. On occasion estimates may indicate that an exceptionally large absorption, or release of reserves from the operation of other factors may require a larger change in the System portfolio in order to meet Committee objectives. On such occasions, the manager of the System open market account or any member of the Committee may request that the limit be changed. This was the case at the meeting of October 25, 1960. At that time estimates of factors affecting member bank reserves over the succeeding weeks indicated that changes in float and currency circulation alone would absorb about three-quarters of a billion dollars bank reserves before November 10 and suggested that implementation of the Committee's directive to conduct open market operations with a view "to encouraging monetary expansion" might require a change in the System's security holdings of more than $1 billion. Accordingly, the manager of the System open market account requested that the limit be raised to $1.5 billion and the Committee granted this request. As it turned out, the change in System outright holdings of securities over the period amounted to $991 million. During the period, reserves supplied temporarily by the acquisition of Government securities under repurchase agreement amounted, however, to as much as $640.5 million, although the net change in securities held under repurchase agreement for the whole period was only $80 million. It might be noted that the limitation does not apply to such repurchase agreements, which are made for the account of the Federal Reserve Bank of New York and which provide reserves on a temporary basis, nor does it apply to purchases and sales of bankers' acceptances.

The limitation stipulated in the directive did not inhibit the manager in the conduct of operations during 1960, and it remains a useful device, since it ensures that a decision of the full Committee, which can be obtained on short notice through a telephone meeting if necessary, must be made if unexpected develop-

ments in the money or securities market suddenly require open market operations in excess of the limitation.

"3. What significance did you expect the manager or the Congress, in later reading of directives, to attach to the phrase in the August 16 meeting 'to take into account even more than usual the tone of the market rather than statistical measures'? What statistical measures were referred to and why were they to be downgraded in importance?"

In providing that operations for the System account during the period immediately following the August 16 meeting should "take into account, even more than usual, the tone of the market rather than statistical measures," the Committee expected the manager to rely to greater degree than customarily would be the case on his intimate knowledge of current money market conditions, as a basis for his judgment of the degree of ease actually prevailing from day to day and of the transactions to be effected in pursuit of the Committee's objective of encouraging monetary expansion. In line with regular Committee procedure, this particular authorization applied only to the period until the next meeting of the Committee, when the directive would again be reviewed and reconsidered.

In the ordinary course and as part of his job, the manager of the account is expected to use his special and expert knowledge of market conditions, along with statistical estimates or projections of available reserves and information regarding the distribution of such reserves, in measuring the prevailing tone of the market. His judgment on this point is, of course, of key importance in combination with statistics in arriving at a determination of the particular transactions needed on any given day in order to attain the Committee's objective. Among the most pertinent statistics he examines are daily projections of total reserves, excess reserves, and borrowings, in the aggregate and by class of bank. He also has available figures on current positions and financing needs of Government securities dealers and the flow of securities through the market, as well as market prices and yields on U.S. Government securities, the prevailing rate on Federal funds, and a variety of other money market data.

By his examination of such statistics and by observing current market developments, the manager of the account is aided in determining the actions needed to maintain or bring about the objectives indicated by the Committee's directive and policy consensus. However, there is no single statistical measure that states or reflects precisely the degree of ease or tightness prevailing in the market at any given time, or the change in the degree of ease or tightness that would be produced by the injection or withdrawal of a given amount of additional reserves. One of the functions of the account manager is to interpret the available statistical data in the light of his expert judgment, and thus to initiate operations that will attain the Committee's objective.

At the August 16 meeting, the Committee felt it desirable to place relatively greater emphasis than usual on the manager's evaluation of the tone and feel of the market. This was because the customary statistical indicators were likely to provide less precise guidance as to the degree of ease or tightness prevailing in the market during the next few weeks as a result of uncertainty regarding member bank response to the actions taken by the Board of Governors of the Federal Reserve System on August 8, 1960. Those actions made additional reserves available through (1) authorizing the counting of vault cash by banks in meeting their reserve requirements effective August 25 and September 1, and (2) reducing reserve requirements for central reserve city banks effective September 1.

"4. Assuming that the System manager is, as is apparently the case, expected and allowed to translate 'shades of opinion' into operational dollar terms, do you feel that this is an adequate explanation to the Congress of the 'determination of open-market policies and the reasons underlying the action,' as required by statute?"

The policy actions of the Federal Open Market Committee and the reasons underlying such actions are, it is believed, adequately explained in the annual report of the Board of Governors. The directive and the accompanying entry that appears in the annual report covering each policy action provide Congress with an explanation of the "determination of open-market policies and the reasons underlying the action," as required by statute. This material is supplemented by the general analytical text covering the events of the year as presented on pages 1–33 of the annual report for 1960.

Significant shades of opinion regarding policy that emerge in the course of Committee discussions are reflected in the Committee consensus and are recorded in the entries for the policy record, later published in the annual report. The bearing that such observations have upon the policy actions taken by the Committee thereby becomes part of the public record.

Additional comment on the use of shades of opinion by the management of the System open-market account appears in the answer to question 5.

"5. In translating these 'shades of opinion,' is the manager expected to consider the number of members voting for or against the directive and assign different weights to the opinions of different members, depending upon what seems to him to have been the most persuasive and best articulated reasons?

The manager of the System open-market account is expected and instructed by the Federal Open Market Committee to pursue operations that will attain the objectives specified by the directive issued by the Committee at any given meeting. He is not expected or authorized to "assign different weights to the opinions of different members, depending upon what seems to him to have been the most persuasive and best articulated reasons."

To assist him in carrying out the necessary operations, the manager has the benefit of the full discussion at the meeting at which a policy decision is reached. The "shades of opinion" expressed by members at a meeting are not necessarily related to the number voting for or against a directive. Such shades of opinion exist when a vote is unanimous, as is often the case, and they may relate to a variety of factors such as timing of operations or emphasis upon one or more of a series of statistical indicators.

In fact, the term "shades of opinion," as used in the introduction to the "Record of Policy Actions" of the Federal Open Market Committee appearing on page 34 of the Board's annual report for 1960, applies to all the Committee discussion, particularly those significant portions that are set forth in the subsequent entries appearing on pages 35–74 covering individual policy decisions. The purpose of the introductory general comment on this point was to indicate to the Congress and others that the manager, by attendance at the meetings, is in a position to know immediately the full background of discussion leading to the wording of the directive and to the additional substantive instructions given by the Committee at the meeting, as set forth in the "Record of Policy Actions."

Many examples of these shades of opinion are contained in the entries covering individual policy decisions. For example, several shades of opinion are reported at the January 12, 1960, meeting in the paragraph at the top of page 37, and in the second paragraph on that page a minority vote and the reasons given in support thereof are presented. The management of the account had the benefit of this full discussion in pursuing the directive calling for "operations with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding opportunities." He was bound by the directive and consensus, however, which was for no change in the degree of restraint that prevailed at the time the meeting convened, and the manager would not consciously have taken a move to change the situation without further instruction from the Committee.

At the January 26 meeting, the Committee decided to continue substantially the same degree of restraint on credit expansion but, to illustrate again the shades of opinion that existed, several members would have preferred to move slightly in the direction of reducing the degree of pressure on bank reserve positions if a large Treasury financing had not been imminent. It was clear that no member then favored increasing the degree of restraint, and one again voted against the directive because he continued to feel that less restraint should be applied.

At the February 9 meeting, the shades of opinion expressed included (*a*) the unanimous view that any tightening in the degree of restraint should be avoided, (*b*) the views of several who leaned toward less restraint, and (*c*) a rather general view that a moderate increase in the money supply would be desirable. However, the majority action, and the wording of the directive issued, was for no change in the existing policy on the grounds that a basic shift in open-market policy was not called for at the time.

At the next meeting, March 1, the directive and the accompanying consensus set forth in the policy record were changed by unanimous vote to wording that called clearly for moderately less restraint. Taking the period January 12 to March 1 as a whole, although the wording of the directive did not change, the shades of opinion recorded in the policy record entries for several meetings

made clear that any doubts as to the effect of transactions in the System account should be resolved on the side of no more restraint, rather than on the side of an increase in pressures on reserve positions of banks.

In sum, whether arrived at by a small or large majority or by unanimous vote, the Committee instruction as to policy and operation of the account is the basic guide that the management of the account is obligated to follow. The directive represents a general statement of Committee policy objectives, which is supplemented by the consensus that emerges from each meeting and forms the basis for the record of the policy decision. Thus, the policy record entry that appears in the annual report is a more complete spelling out of the Committee's instructions and reasoning than is the directive taken alone. Within the framework of the directive, however, the manager of the System account may be expected to derive assistance in understanding the intent of the Committee in issuing its instruction because of his knowledge of the views expressed in the process of arriving at the Committee's decision.

"6. In purchasing or selling securities, do you ever expect or direct the account to take an active forceful role by purchasing securities above or below the current price for the purpose of changing the level of interest rates? If this is never done, is not the role of the System reduced to that of a follower rather than a leader?"

The Federal Open Market Committee does not direct the account management to make purchases above current prices, or to make sales below current prices, in carrying out transactions for the System account. Transactions for the account, rather, are made on a "best price" basis, that is, purchases are made at the lowest prices offered, and sales at the highest prices bid at the time the transactions are effected. This procedure is utilized in order to avoid arbitrary discrimination among dealers and disruptive market effects. Nevertheless, it permits the Federal Reserve to assume an active, forceful role in influencing conditions in the money and credit markets when this is deemed desirable. Such influence is exercised primarily through changes in the supply of bank reserves, although interest rate considerations may at times be of importance.

The System is a large participant in the Government securities market and its operations affect the expectations of other participants in that market as well as general expectations regarding money conditions. System transactions in Government securities consequently have an immediate effect on prices and yields, as do the large transactions of any other market participant. The magnitude of this effect, in the case of purchases, depends primarily on the size of the operation relative to the volume of securities available in the market, including those in dealers' positions as well as those flowing into the market from customers, at prices that are at, or close to, those currently being quoted. Similarly, the immediate impact of System sales will depend on the strength of bids for securities in the market, including those by dealers for positioning and for filling orders for customers. By operating on a "best price" basis, the System permits the market to adjust continuously to the volume of transactions actually effected. To operate otherwise would tend to weaken the value of the knowledge that a free market, where the individual decisions of buyers and sellers are worked out, can provide.

The immediate focus of System open market operations is to regulate the reserve positions of banks and in this way to make possible a flow of bank credit and money adjusted to the needs of the economy. The bulk of operations are designed to offset undesired short-term variations in other factors affecting bank reserves and to provide for seasonal and other temporary needs for reserves. Open market policy thus helps to dampen the very wide short-term variations in securities prices and yields which would tend to occur in the absence of System actions. From the standpoint of such day-to-day operations, therefore, the question of "leading" or "following" the market does not arise.

Contracyclical monetary policy is carried out simultaneously with operations conducted to provide for seasonal and other short-term reserve needs and in practice the two sets of operations cannot be separated. The extent to which factors making for temporary changes in reserves are in fact offset—or, occasionally, reinforced—by System operations depends on the direction in which monetary policy is moving in its economic stabilization function. It is in carrying out its continuing contracyclical function that the Federal Reserve may be said to have an active, leadership influence on money and credit flows and thereby on market interest rates.

Through influence on market expectations, bank credit and monetary policy also have effects on interest rates in addition to, or even prior to, those resulting from changes in bank reserve positions and in market supplies of securities. Expectational responses to System actions, by accelerating market adjustments in prices and yields of securities to cyclical movements in the economy, give monetary policy an additional leverage in its efforts to counter economic instability. At the same time, the risk that the response of market psychology may be excessive requires that the authorities be careful in undertaking actions or operations that might appear to signal an abrupt change in prevailing credit conditions.

"7. Reference is made on several occasions to 'relating the supply of money in the market to the needs of commerce and business.' What significance has this statement in a policy directive unless related to some equilibrium level of interest rates?"

Clause (1)(a) of the directive of the Committee has specifically provided for operations of the System open market account to be undertaken with a view, among other objectives, to relating the supply of funds in the market to the needs of commerce and business. This is one method by which the Committee keeps clearly before its operating officials the responsibilities for accommodating commerce and business as established under section 12A of the Federal Reserve Act.

This statement in the policy directive relates mainly to the function of the Federal Reserve System in offsetting seasonal, regional and random flows of funds that might suddenly cause undue stringency in bank reserve positions and in the money market. Prior to the establishment of the Federal Reserve System, such flows of funds at times aggravated, or even caused, serious financial and economic disturbances. The statement therefore refers to the more routine functions of the Federal Reserve System involved in preventing temporary distortions in money flows from having a disturbing effect on the economy. The policy instructions of the Committee are contained elsewhere (clause (1)(b)) in the directive to the New York bank.

The needs of commerce and business are of course accommodated by a relatively stable reserve base, and the System's marginal operations referred to above must be related to these needs. Widely varying needs for funds are generated in the regular course of business activity. Holidays such as the Fourth of July and the Christmas season, for example, produce sharp increases in currency used by the public which, unless offset by Federal Reserve action, would produce strong temporary pressures upon bank reserve positions. Needs for credit accommodation are also associated with such seasonal developments as quarterly tax payments and the harvesting and processing of agricultural commodities. Variations in credit needs of a longer run nature accompany cyclical business expansions and the underlying trend of economic growth.

Some of these types of shifting credit needs are sufficiently repetitive to be projected in advance on the basis of historical patterns. Other needs, less amenable to regular projection, may sometimes be forecast or perceived soon after their inception. The manager of the System open market account has prepared daily estimates of aggregate reserve sources and uses for a number of days ahead which embody adjustments for many of these developments. In his operations, the manager makes such allowance for these market developments as appears practicable within the degree of general monetary ease or restraint which the Federal Open Market Committee has directed to be maintained. In terms of volume, the open market operations undertaken by the account to offset or compensate for market factors affecting reserves far overshadow the volume of operations necessary in order to achieve such changes in general reserve availability as are called for by the Committee.

The kinds of demands for funds outlined above interact in varying degrees with the prevailing state of credit availability and interest rates. Some repetitive needs for funds are sufficiently insensitive to interest rate changes to produce substantial upward fluctuations in market interest rates in the absence of offsetting reserve provisions. Such a pattern often materialized near the end of each year prior to the establishment of the Federal Reserve System, as the market worked to equilibrate insistent seasonal demands for funds with an inelastic supply. Federal Reserve operations, by providing appropriate adjustments in the credit base, aim to minimize the degree to which the onset of seasonal and other pressures can produce departures from the conditions of general credit availability being sought by overall monetary policy.

"8. In connection with the indications that the Board considers the growth of time deposits in commercial banks as having expansionary effects, precisely what is the Federal Reserve policy with respect to time deposits during periods of inflationary pressures or during periods when stimulation of general economic activity is desired?"

Because of the diverse effects of the savings and liquidity aspects of time deposits in commercial banks on spending and economic activity, an appraisal of the significance of their growth must be based on constant study of the various forces underlying such growth. Over the long run, increases in time deposits in commercial banks as well as in other forms of savings facilitate investment and contribute to economic development. Over the economic cycle Federal Reserve policies tend to encourage bank credit and deposit expansion at times when stimulation of general economic activity is desired, and to restrain them during periods of inflationary pressures. Growth in time rather than demand deposits is preferable during periods of inflationary pressures since they are less liquid, but the form of deposits in which holders wish to keep their funds is mainly a function of the needs and desires of holders rather than the actions of the Federal Reserve. Thus, the amount of demand deposit expansion appropriate for any particular economic situation is affected to some extent by the concurrent rise in time deposits as well as in other forms of liquidity.

Time deposits in commercial banks are at the same time a form of savings and a reservoir of liquidity. They are a highly liquid form of asset and are readily convertible into cash, with no fluctuation in capital value, although some sacrifice of interest is usually involved.

As a form of both savings and liquidity, time deposits in commercial banks have some influence on the volume and timing of consumption and investment, and hence the course of activity over the economic cycle as well as in the longer run. Current additions to time deposits, in turn, also reflect the economy's decisions to spend or save. For example, when spending tends to diminish, consumers or businesses may add part of the additional unspent income to time deposits. Thus, movements of these deposits are, like many other facets of economic activity, both cause and effect of such activity.

Time deposits differ from many other forms of savings in that they are subject to more public regulation. Since most time deposits in commercial banks are liabilities of member banks of the Federal Reserve System, they are subject to legal reserve requirements and maximum interest rate regulation. Reserve requirements against time deposits limit the degree of multiple bank credit expansion that can be built up on the basis of a given amount of reserves in case some of the bank funds made available are held in the form of time deposits. Federal Reserve policy takes account of both the savings and liquidity aspects of time deposit growth at commercial banks.

"9. Does the size of the Open Market Committee have anything to do with the vague and very general wording of the policy directives?"

The size of the Federal Open Market Committee has little, if anything, to do with the wording of the policy directive, once the Committee has decided by unanimous vote or otherwise what its policy goal is to be.

Clause (b) of the first paragraph of the directive specifies the economic goal or objective of current policy. This is a statement that must guide operations over a period of several weeks and, appropriately, is in rather broad terms, irrespective of the size of the Committee. A distinction should be made between this policy goal statement and the detailed operating procedures or techniques to be followed in attaining such goal. This distinction—not the size of the Committee—is the determining factor in the type of wording used in the Committee's directive, when the policy decision has been arrived at.

As an example, the wording of the directive adopted at the last meeting in 1960 provided that open market operations be with a view "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments." This language set out in concise and definite terms the policy objectives of the Committee at that particular phase of the business cycle. It was not designed to provide detailed instructions for day-to-day operations of the System account in pursuit of the goal, but it was designed to make clear the Committee's purpose that should guide the manager of the System account in executing transactions. Such a guide would be necessary, regardless of the size of the Committee. Also, regardless of the size of the Committee, more detailed guidance may be given within the framework of the directive. In practice, such guidance to the manager is contained in the consensus that is reached at

each meeting of the Committee, as set forth in the "Record of Policy Actions."

"10. Among several references noting that the money supply had failed to respond as anticipated, the September 13 summary refers to the change as 'disappointing.' Is it your contention that the Federal Reserve is sometimes frustrated in its attempt to increase the money supply and, if so, how and why?"

The particular variable over which the System exercises major influence is the total of commercial bank reserves. Through its influence over reserves the System is able to have a significant effect on total loans and investments and total deposits of banks, and through these variables some effect on the volume of spending, investment, and saving by the public in general.

It is never possible to predict exactly the expansion of bank credit and money which will result from a given addition to total reserves. Depending on the strength of public and private credit demands, the liquidity of banks and their willingness to borrow, and many other factors, the supply of reserves made available by open market operations or reserve requirement adjustments may be used in many ways. Banks may accumulate excess reserves, repay indebtedness, or utilize the reserves as a basis for deposit expansion. Typically, some part is likely to be employed in each of these ways. At times the bulk, if not all, of the reserves provided may flow into one use rather than another.

The quoted observation in the policy record for September 13 related to the fact that, despite the substantially larger than seasonal increase in total reserves since May, the increase in the seasonally adjusted money supply through August had been very moderate. In this sense the Federal Reserve may be "frustrated" at times in endeavoring to foster an increase in the money supply, because the monetary expansion resulting from its actions to supply reserves is less than was anticipated on the basis of previous experience. Responses of less than anticipated dimensions can be, and are, taken into account in subsequent policy formulation, as is demonstrated by the policy record cited in this question.

"11. Does the Board take into account or attempt to estimate the member banks' demand for free reserves or liquidity as well as the supply of these reserves? Is the rate of interest on Federal funds an important indicator influencing the direction and extent of open market operations?"

The Federal Reserve does take into account the member bank demand for reserves in its actions to affect the supply of reserve through monetary policy. It does this both in the short run to allow banks to meet the seasonal and other temporary demands for financing on the part of the Government and private borrowers, and in the longer run to contribute most effectively to sustainable economic growth.

The significance of the level of free reserves or net borrowed reserves in the banking system as a factor tending to encourage or restrain bank credit and monetary expansion depends, among other factors, on the demand for reserves. The demand for reserves, in turn, depends on the vigor of actual current demands for bank credit, the existing level of overall bank liquidity, shifts between types of deposits, and the variation among the different classes and groups of banks with respect to these factors.

If the Federal Reserve responds fully to demands for reserves by supplying them through open market operations, member bank borrowings are unlikely to rise and excess reserves unlikely to fall. If, however, the Federal Reserve judges that some restraint on bank credit and monetary expansion is appropriate, it will supply through open market operations a smaller volume of reserves than is being demanded. As a result, there is likely to be an increase in the level of member bank borrowings or a reduction in excess reserves. In these circumstances, banks tend to moderate their credit expansion.

At other times, when economic activity is slack and when credit demands are light or banks prefer to increase their liquidity rather than to expand their loans, it is appropriate for the Federal Reserve to supply banks with more excess reserves in order to encourage bank credit and monetary expansion. Thus, in providing an appropriate supply of reserves, the Federal Reserve takes into account (1) the demand for them, (2) the desirability of encouraging or restraining bank credit and monetary expansion, (3) the desire of banks for liquidity, and (4) the willingness of banks to borrow in order to obtain reserves.

The rate of interest on Federal funds is an important indicator, but only one of several important indicators, that is used to evaluate current conditions in the money markets and thus to determine whether action by the manager of the Federal open market account is necessary or desirable in order to carry out the current directive of the Federal Open Market Committee. The Federal

funds rate indicates mainly supply-and-demand relationships in one segment of the money market; namely, the market for one-day bank funds. It reflects particularly short-term variations in the reserve needs of individual banks and their efforts to balance their reserve positions or to put excess reserves to use within the period they are permitted to use for reserve computation purposes.

The spread between the Federal funds rate and the discount rate reflects rather accurately day-to-day changes in the distribution of reserves among larger banks, and hence their short-run lending and investing ability. This is especially true in periods of credit ease. The general state of credit markets even in the short run, however, is more accurately reflected in money market rates other than the Federal funds rate, particularly those for Treasury bills.

"12. For each of the five or six changes in key words of the policy directives do you feel that a reporting of this change in language meets the requirements of a full disclosure to the Congress of the actions taken and the reasons underlying the action?"

Changes in the language of the general policy directive of the Committee were made at the Committee's meetings of March 1, May 24, August 16, and October 25, 1960. The underlying reasons for these changes are set forth at pages 43, 55, 63, and 70, respectively, of the Board's 1960 annual report. In addition, the policy record entry for each of the Committee's meetings contains a summary of the consensus of the Committee reached at that meeting, spelling out Committee objectives in more detail than in the broad policy directive. The "Record of Policy Actions" is supplemented by an integrated analysis appearing on pages 1–33 of the report with respect to general economic and financial developments during the year.

It is believed, therefore, that the Board's 1960 annual report clearly meets the requirements of the law for full disclosure to the Congress of the policy actions of the Committee and of the reasons underlying such actions.

"13. For each of these actions (1) what combination of economic indicators prompted the action, (2) what evidence is there of market response, and (3) did the response match, fall short of, or surpass expectations or aims?"

In answering these questions, it needs to be recognized that formulation and execution of monetary policy is a continuous process that requires constant review of economic and financial developments and adaptation to such developments. Consequently, changes in the directive do not necessarily represent a sharp change in the direction of policy. Moreover, within a given directive there is room for variation in policy execution in response to changes in credit conditions and market behavior. Such variations are generally reflected in the consensus of the Committee that is reached at each meeting as to the course of policy execution in the period ahead.

Broad economic objectives of the Committee are by their nature expressed in general terms. The processes and procedures through which policy is executed in the short run are necessarily more specific and concrete. Monetary policy exerts its influence almost immediately and directly upon the volume of commercial bank reserves, the amount of which can be promptly and accurately measured and can be largely controlled by Federal Reserve actions on its own initiative. This control is not complete because member banks may on their initiative borrow reserves or use reserves to reduce borrowings at the Reserve banks. Through the medium of bank reserves, policy actions influence the amount of credit that commercial banks extend and thereby influence the money supply. These secondary effects are in turn strongly affected by the attitudes and actions of banks in adjusting to changes in reserves and in their willingness to borrow from the Reserve Banks. They are also affected by the decisions of borrowers with respect to the use of bank credit.

Ultimate consequences of changes in the money supply upon general economic activity, employment, and prices are determined by eventual holders of funds, who are motivated by many factors other than cash holdings. More especially, the bulk of current financial transactions reflects the use of existing funds rather than changes in the total volume of cash balances and these uses are likewise influenced by many factors of a nonmonetary nature. All of this means that, although monetary policy actions have marginal effects of significance, assessment of these consequences is generally difficult and sometimes impossible. It must be to some extent a matter of judgment.

Answers to the first section of this question, namely, what indicators prompted the Committee's actions, are fully, though briefly, set forth in the record of policy actions for the meeting at which the new directive was adopted. This

record gives the essential points of the Committee's discussions that formed the basis for the decision as to the directive and that served as a guide for subsequent operations by the account management. Material presented in this answer represents principally a summary of the points set forth in the policy record.

Answers to the section section of the question, relating to market response to System actions, require an analysis of events that followed each change in the wording of the directive, as well as an appraisal of actions by the account management in carrying out the directive, in light of more specific instructions growing out of the Committee's deliberations and also in the light of changing money market conditions. Answers to this question can also generally be found in the records of deliberations at subsequent meetings of the Committee. These records contain brief analytic descriptions of economic developments that accompanied or followed preceding System actions. They often specifically point out relationships between these events and System aims and actions.

The third section of the question, which would relate response to expectations, requires a hindsight analysis and is most difficult; if not impossible, to answer in any concrete terms. As noted above, monetary policy execution is a continuous process, one which usually involves probing or testing actions. If in the course of events these actions do not seem to be obtaining the desired results or seem to be unnecessary or in the wrong direction, they are modified or discontinued. A process of constant adaptation to current developments is a part of the task of conducting current System operations to promote the desired aims.

More importantly, it is not to be expected that Federal Reserve actions alone can assure the attainment of ideal economic conditions. The effects of other factors are difficult to appraise. It is possible to determine quickly the amount of bank reserves that were available, and information as to changes in the volume of bank credit and the money supply can be had fairly readily and accurately. It is a matter of judgment, however, rather than of precise measurement, to make an assessment of the secondary effects of these direct and measurable consequences of monetary policy, relative to the effects of various other factors, in determining the course of interest rates, prices, employment, and general economic activity. To make such a judgment it is essential to consider and appraise not only monetary policies but also other significant influences, including private actions, as well as various Government policies.

Five versions of clause (b) in the Open Market Committee's policy directives, including the one in force at the beginning of the year, governed Federal Reserve operations in the course of 1960. The three parts of this question are discussed separately with respect to each of these directives.

I. January 12, 1960

Directive, clause (b): "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities."

(1) What combination of economic indicators prompted the action?

This particular directive had been first adopted on May 26, 1959, and had been continued since that time. The principal factors providing the basis for this directive, as set forth in the policy record for May 26, 1959, included expanding productive activity; a growing belief that creeping inflation was inevitable and actions to hedge against its results; highest level of construction contracts on record; rising industrial prices; robust expansion in consumer installment credit; other unseasonably large private credit demands, accompanying heavy Treasury borrowing; further significant expansion in the money supply and in the turnover of deposits; and increased borrowing by member banks at the Reserve banks to sustain bank credit expansion.

As these or other similar forces continued to be evident with some variations in degrees of intensity or in composition during the rest of 1959, the policy directive remained unchanged. The steel strike in this period was an especially potent and disturbing influence both in limiting resources and in creating uncertainties as to future commitments. At times there were variations in the conduct of policy with respect to the degree of restraint or ease, but the general aim continued to be one of restraint on inflationary bank credit expansion in the face of vigorous current and prospective private credit demands, along with heavy borrowing by Federal, State, and local governments and an increased flow of individual savings. Expansion in total credit in 1959 was larger than in any previous year, with bank loans contributing to the growth. Because of restraint on bank credit expansion, banks obtained funds to increase their loans by selling securities to nonbank investors. The bulk of the growth in credit was supplied directly or indirectly by nonbank lenders making use of available funds.

At the beginning of 1960, principal economic indicators were moving up, and settlement of the prolonged steel strike was believed to remove a major element of uncertainty. Increases in interest rates and severe pressures on the money market in December were attributed to inventory restoration and to widespread market expectations of a forthcoming boom, as well as to usual seasonal factors that generally involve very large cash needs at that time. Declines in interest rates in January were due in part to seasonal influences but also to some slackening in credit demands and to anticipations of a Federal budgetary surplus. The prevailing view as to economic prospects, however, was one of great optimism, with expectations of continued expansion in activity and pressure on resources. Although there was some sentiment in the Committee at the time for a slight lessening of the degree of restraint, the consensus was that, in view of the prevailing attitude of extreme optimism, relaxation of restraints would be likely to stimulate excessive reliance on credit financing, particularly from banks.

(2) What evidence is there of market response?

Federal Reserve policies under this directive, which was in force from late May 1959 until March 1, 1960, were directed toward restraint on bank credit and monetary expansion in view of vigorous credit demands and limited resources. Response is indicated by the moderate rate of total bank credit expansion in the period. The record increases in total credit—bank and nonbank—and the rise in interest rates that occurred in 1959 are indicators of the vigor of credit demands in that period. The total of funds advanced in all credit and equity instruments exceeded $60 billion in 1959, compared with an average for previous years of around $40 billion. The Federal debt increased $11 billion and other debt increased by a record $50 billion. Growth in bank credit was a moderate $5.5 billion and the money supply, which had expanded abruptly during 1959 and the early months of 1959, declined somewhat in the latter part of 1959 and in early 1960. The turnover of money increased throughout the period and other liquid asset holdings of the nonbank public continued to increase at a rapid pace.

Vigor of overall credit demands, together with restraint on bank credit expansion, resulted in rising interest rates, which in turn helped to bring forth savings to meet credit needs without undue monetary expansion. The limited increase in total bank credit and the money supply and the drawing in of such large amounts of savings to meet the large credit demands that developed in 1959 reflected the influence of Federal Reserve policy. The resulting rise in interest rates served to draw savings into use and made unnecessary the creation of additional money to finance the high level of economic activity that prevailed.

In the early weeks of 1960, increased supplies of steel and other products became available, while the Federal budget developed a surplus. Savers continued to invest in securities; they bid securities from banks to such an extent that interest rates declined, while the money supply decreased. Although private credit demands were well sustained and total liquid assets of the public continued to increase, total loans and investments of banks and the money supply showed a greater than seasonal decline. It began to become evident that there could be some relaxation from the degree of restraint on bank credit that had been necessary in 1959. At successive meetings of the Committee in January and February, sentiment for relaxation of credit restraint increased.

(3) Did the response match, fall short of, or surpass expectations or aims?

In 1959, the aim of monetary policy was to limit the creation of additional money at a time when credit demands were exceptionally strong, while liquidity in general was large and the resources available for further expansion in output were limited. In view of the steel stoppage, which placed a limit on available productive resources, a higher level of economic activity could hardly have been attained in 1959. Under the circumstances, unrestrained expansion in credit-financed demands would no doubt have exerted strong inflationary price pressures with little or no sustainable contribution to increased employment. Had bank reserves been more readily available, it is reasonable to conclude that credit and monetary expansion would have been much greater with more unstabilizing consequences.

It cannot be inferred that credit restraints in 1959 were the sole or even the principal factor moderating inflationary developments or that the downturn that developed later was due to shortage of credit. It might be concluded, rather, that monetary policy by helping to prevent excesses made a positive contribution to avoidance of a more severe and prolonged recession. A key influence in stopping further expansion in economic activity was the failure of consumer

buying to keep pace with potential or even actual output of consumer goods or with consumer income. This was in large part due to factors other than credit availability, such as resistance to prices, uneven distribution of increase in income, and shifts in consumer tastes. It is possible that by early 1960 the higher interest rates and resulting stimulus to saving may have been a factor in limiting consumer buying.

The lag in consumer buying, relative to output, was reflected in business inventory accumulation, which was the most outstanding element of instability in 1959 and 1960. Disturbances in the pattern of normal business expansion that were forced by the prolonged steel stoppage, with a tentative resumption of operations while negotiations were in process, also exerted an unstabilizing influence with respect to inventories and to business plans and commitments. For example, early in 1960 it began to be apparent, to the surprise of many, that inventories of steel and steel products had been built up to a much higher level than would be needed with resumption of productive operations. The continued large Federal budget deficit during the period of expanding private activity in 1959 and the quick shift to a moderate surplus was also an element of instability.

Early in 1960 the slackening of credit demands and a general market reevaluation of the business outlook, with continued strong nonbank demand for securities, obtained an immediate market response in a decline of interest rates. The money supply also declined somewhat more than seasonally, reflecting in large part continued purchases of Government securities from banks by nonbank investors. Thus total no bank holdings of liquid assets continued to increase, even though the money supply declined. This was reflected in a greater than seasonal decline in required reserves. The reserves released were not fully offset by Federal Reserve actions, and there was a moderate decline in net borrowed reserves. This brought about an easing of the credit situation before there was any indication of an economic downturn.

In summary, it may be said that Federal Reserve policy under this directive served in 1959 to prevent excessive bank credit expansion at a time of relatively full utilization of resources that were limited by the steel strike and when there were strong credit demands with widespread expectations of inflationary tendencies. Early in 1960, for a variety of reasons, the underlying forces changed—contrary to prevailing expectations at the time—and it gradually became increasingly evident that credit restraints could be relaxed.

II. March 1, 1960

Directive, clause (b): "to fostering sustainable growth in economic activity while guarding against excessive credit expansion."

(1) What combination of economic indicators prompted the action?

Although reports of economic developments at this time indicated continuance of underlying economic strength, it appeared that some earlier exuberant expectations were not being fully realized and that there was less need for restraint to guard against credit excesses. Resumption of inventory expansion seemed to be an indication of a slackening of demand relative to output rather than a factor of strength. Although the increase in bank loans was substantial, particularly to finance the increase in business inventories and also to finance consumer purchases on credit, the increase was exceeded by bank sales of Government securities to nonbank investors, and total bank credit and the money supply were decreasing. Accordingly the Committee concluded it would be appropriate to supply reserves more readily and to follow a policy of moderately less restraint.

In view of these developments, the Committee decided to eliminate from the directive the reference to inflationary credit expansion. Retention of safeguards against permitting excessive credit expansion were deemed essential, however, as the basic situation seemed to be strong, particularly in other countries, and there was some uncertainty as to how much the slowdown in trade might be due to the temporary influence of severe weather conditions.

(2) What evidence is there of market response?

During the 2 months or more following adoption of this directive, economic activity was generally maintained at a high level with little or no further growth. With more favorable weather conditions in April, there were some evidences of a resumption of upward tendencies, but with no pronounced upturn or shift in tone. In the financial area, although private credit demands were

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moderately strong, bank holdings of Government securities and the seasonally adjusted money supply continued to decline. Growth in nonbank holdings of liquid assets other than money tended to level off, reflecting in part a reduction in the volume of short-term Government securities outstanding. Turnover of demand deposits continued at a higher level than during the preceding year.

Federal Reserve operations added to the availability of reserves, supplementing amounts released through the more than seasonal decline in required reserves. Member bank borrowings were reduced from over $800 million in February to about $500 mililon in May, and net borrowed reserves declined to a small amount. Interest rates showed marked declines, in reflection of both reduced credit demands and increased availability of bank reserves.

(3) Did the response match, fall short of, or surplass expectations or aims?

Federal Reserve operations under this directive increasingly moved in the direction of supplying more reserves to banks but the response was not altogether satisfactory. One of the most striking developments of this period (March to May 1960) was the sharp decline in interest rates, along with the maintenance of a fairly high level of economic activity and moderately strong private credit demands. This course of events may be attributed in part to a shift in the Federal Government's fiscal position from large net borrowings to net retirement of debt. It may also have reflected the effect of the previously higher interest rates in drawing savings from cash-type assets into income-yielding liquidity instruments and other investments and perhaps stimulating additional saving. This decline in interest rates was enhanced by the Federal Reserve policies and actions during this period.

Neither borrowers nor lenders, however, responded with alacrity to increased availability of credit. The Federal Government was reducing debt and private credit demands did not increase sufficiently to offset the decline. Interest rates declined, but showed tendencies to fluctuate widely in reflection of actual or anticipated variations in supply or demand conditions in credit markets. Although availability of bank reserves increased, many banks still found it necessary to borrow reserves either from the Reserve banks or from each other.

In this period, although consumer incomes continued to increase and consumer credit extensions were at a high level, consumer spending failed to keep pace with actual or potential output. It was becoming apparent that the net accumulation of business inventories had been excessive. This period was characterized by a lag in spending relative to current income as well as to resource availability. It was apparent that there were important factors other than the availability of bank credit that shared responsibility for this lag and for the shifts in attitude, which together provided the basis for subsequent downward adjustments in output and employment.

III. May 24, 1960

Directive, clause (b): "to fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion."

(1) What combination of economic indicators prompted the action?

Information available at the time of this meeting, partly preliminary, suggested that gains in economic activity that seemed to be developing in April may not have been realized and in any case were not general. Although System operations under the former directive had increasingly moved in the direction of supplying more reserves to banks, total credit demands were moderate and the seasonally adjusted money supply was tending to decline. In addition, there had been a pronounced relaxation of the inflationary psychology prevalent earlier.

Under the circumstances, it was evident that the directive needed to be revised to call for a further supplying of reserves with a view to fostering moderate expansion in the bank credit and encouraging an increase in the money supply that might be needed for sustainable growth.

(2) What evidence is there of market response?

Under this directive, operations were more vigorously conducted toward increasing the availability of bank reserves, enabling banks to reduce their borrowing, and bringing about declines in interest rates. Federal Reserve holdings of securities increased by over $1 billion from May to August; Federal Reserve bank discount rates were lowered from 4 to 3½ percent in June and to 3 percent in August, and action was announced in early August to release reserves by

authorizing member banks to count additional amounts of vault cash as reserves and reducing reserve requirements at central Reserve city banks to become effective late in August and on September 1. Also in late July margin requirements on stock market credit were reduced moderately from 90 to 70 percent, following a decline in stock prices, relatively low trading activity, and a reduction in stock market credit.

Member bank borrowings at the Reserve banks decreased from an average of $500 million in May to less than $300 million in August, with net free reserves averaging about $250 million in the latter month. Interest rates declined sharply in all sectors of the market. Both loans and investments at banks increased, and the seasonally adjusted money supply turned up in June and continued to increase in July. Long-term borrowing by corporations and by State and local governments increased.

Outside the financial area, economic activity, although continuing into the summer at a high level, was evidencing no upward momentum. Uncertainty regarding future trends was becoming more widespread and there was a gradual increase in unutilized plant capacity and manpower. Reports from business corporations indicated a decline in profits. While consumer demand was a sustaining influence, it was not providing a stimulus for economic expansion. Final sales of goods were running short of output and inventories continued to expand.

(3) Did the response match, fall short of, or surpass expectations or aims?

In reviewing developments from May to August, it would appear that in the financial area the response to shifts in Federal Reserve policies and operations was in the desired direction. Credit and monetary contraction ceased and there was in fact some monetary expansion. Interest rates declined. Although economic activity in general seemed to be continuing at a relatively high level with no evidence of a downturn, the lack of growth and the underutilization of resources were matters for concern. Failure of the economy to expand could appropriately be attributed to factors which caused spending and investment not to increase, while production was maintained and incomes continued to expand. As a result, inventories were accumulating, although they did not appear to be excessive relative to sales, and unemployment of labor and idle resources were tending to increase. Under the circumstances, although the lag in spending could not be attributed to shortage of credit, it appeared that availability of credit could be made easier with little risk of excess and with possibly some stimulating effect.

IV. August 16, 1960

Directive, clause (b): "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment."

(1) What combination of economic indicators prompted the action?

This new directive was designed to give greater emphasis to the need for operations that would help stimulate expansion, by removing the limiting words "moderate" and "needed" from the directive previously in force. The reason for its adoption was principally the failure of the economy to expand in preceding months, with a resulting widening of the gap of unutilized resources and unemployment. Action had just been taken to release additional reserves and to lower discount rates. It was the committee's intention that these measures be strengthened by operations that would further expand the availability of reserves and give greater encouragement to bank credit and monetary expansion. It was also thought possible that reserves supplied through the release of vault cash might not be fully utilized promptly and that, therefore, somewhat larger amounts of excess reserves would be needed to obtain the desired stimulus.

(2) What evidence is there of market response?

Following adoption of this directive, rather large amounts of reserves were made available through increases in Federal Reserve holdings of Government securities, as well as through the previously announced action with response to vault cash and reserve requirements. The reserves thus made available were adequate to cover heavy seasonal needs and to offset an accelerated gold outflow as well as to make possible greater than seasonal additions to the volume of reserves. Member bank borrowings declined, with some weekly fluctuations, to a negligible figure by the end of the year, and net free reserves rose to an average of nearly $500 million in October and to over $600 million in November.

Although banks responded rather slowly to the increased availability of bank reserves and there was no credit growth in August, bank loans subsequently increased more than seasonally, especially business loans, and banks also added to their investments. The money supply, though leveling off in August, increased moderately in September and October, but declined in November. The principal counterpart to the expansion in total loans and investments of banks was an exceptionally rapid growth in time deposits. Nonbank holdings of Government securities declined somewhat. Long-term financing by corporations and by State and local governments continued moderately heavy.

Notwithstanding the easing in the banks' reserve positions interest rates showed little or no further decline after mid-August. This leveling out of interest rates may be attributed in part to the continuation of private demands for credit at fairly good levels and the reduced liquidity position of corporations. Interest rates were also maintained to some extent by large-scale advance refunding operations by the U.S. Treasury, when institutional investors made significant readjustments in their holdings of Government securities. A technical market factor was a reduction in the inventories of securities dealers, following a buildup during the summer.

One new factor of particular importance in maintaining interest rates, in the face of declining economic activity and an easy money policy, was the flow of funds abroad that accelerated in September and resulted in exceptionally heavy drains on the country's gold stock during the remainder of the year. Although the drain on bank reserves exerted by these gold movements was offset by Federal Reserve actions, the shifting of funds incidental to the movement had a disturbing effect on credit markets. This flow of funds abroad was also an influence toward holding down the expansion in the domestic money supply. Since this outward flow of funds was due in part to the lower level of interest rates in this country than in foreign money markets, as well as to confidence factors, more vigorous action on the part of the Federal Reserve to supply additional reserves would have incurred the risk of accelerating the gold outflow and thus would not have served the intended purpose.

In September and October, moderate recession in economic activity became increasingly evident. Although aggregate final takings of goods and services were maintained or increased somewhat, inventory contraction and some curtailment in purchases of durable goods resulted in a moderate decline in total production. The accompanying increase in unemployment was more marked. There were also decreases in residential construction and curtailment in business plans for plant and equipment expenditures.

(3) Did the response match, fall short of, or surpass expectations or aims?

In this period, as in the preceding one, monetary policy was directed toward encouraging credit expansion in order to foster growth in the economy. The adoption of more vigorous measures was inhibited and the effectiveness of the action taken was diminished by the outflow of funds to foreign markets. This movement, which caused a drain on U.S. gold reserves, was induced by interest rate differentials and uncertainties as to future developments. Interest rates stopped declining, though they remained much lower than in previous months; further measures to lower rates, it was believed, would accelerate the gold outflow. Moderate expansion of bank credit and the money supply did occur, although the rate of expansion was sometimes disappointing. Nevertheless, largely for reasons other than credit availability, recession in economic activity developed.

V. October 25, 1960

Directive, clause (b): "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration international developments."

(1) What combination of economic indicators prompted the action?

The only change in the directive from that previously in force was the addition of the clause with respect to international developments. Deepening of economic recession in the United States called for continuation of action to maintain ready availability of bank reserves. Yet the persistent outflow of capital abroad, induced in part by interest rate differentials and confidence factors, precluded policies that would vigorously push down interest rates, particularly short-term rates, or that would raise fears abroad that inflationary policies were being adopted during a period of serious balance-of-payments stress. It was to indicate recognition of this situation that the new clause was added to the directive.

Specific action to implement this directive taken by the account management was to extend open market operations to the purchase of short-term securities other than Treasury bills. There seemed to be a particularly strong demand for Treasury bills in the market but a more abundant supply of other short-term issues available for purchase. In view of the imminent very large seasonal needs for bank reserves to cover currency demands and credit expansion, as well as the gold outflow, the System account faced the need for making very heavy purchases of securities in the weeks ahead. It was desirable that these be acquired with a minimum of downward pressure on the short-term Treasury bill rate, which occupies a key position with reference to international money flows.

Subsequently, action was taken to release a large amount of reserves by authorizing banks to count all of their vault cash holdings in meeting reserve requirements and at the same time making some partly offsetting adjustments in reserve requirements. This action, which was taken to put into effect legislation adopted in 1959, provided another means of supplying reserves while minimizing Federal Reserve purchases of Government securities and consequent effects on interest rates.

(2) What evidence is there of market response?

In order to carry out this directive, while meeting seasonal currency demands and increases in required reserves as well as a continued heavy outflow of gold, heavy purchases of securities were made by the Federal Reserve in late October and during November, including Treasury bills and other short-term issues, as well as some repurchase contracts. In December, reserves were plentifully supplied by the release of vault cash, and System sales of securities exceeded purchases. In this period member bank borrowings declined to a relatively negligible amount and free reserves exceeded $600 million.

Interest rates did not show the increase usual in the December period of heavy liquidity demands, and in fact some rates declined—in the medium- and long-term sectors, as well as in the short-term area. Bank credit increased more than usual, chiefly through acquisition of Government securities, and the seasonally adjusted money supply, after declining in November, turned up again in December. Total liquid asset holdings of the nonbank public, after showing little change during the first half of 1960, increased somewhat in subsequent months. Bank liquidity had also improved, with increases in holdings of short-term Government securities and in time deposits, while bank borrowings were reduced, but the banks' loan-deposit ratios were higher than in earlier years.

The moderate downdrift in economic activity continued during the last quarter of 1960, with unemployment rising to a seasonally adjusted rate of 6.8 percent of the labor force. Prices of sensitive materials showed further declines. Consumer buying decreased somewhat, after seasonal adjustment, but most of the curtailment in output continued to be accounted for by inventory curtailment, particularly in the manufacturing sector. Trade inventories rose throughout the year. Personal incomes were well maintained, in part through transfer payments, but corporate profits were estimated to be relatively low. Government expenditures were tending to increase, while revenues remained at a high level, continuing to provide a seasonally adjusted cash surplus in the Federal budget.

(3) Did the response match, fall short of, or surpass expectations or aims?

Again it might be said that, under the circumstances prevailing with respect to nonmonetary forces and the international situation, the response in the financial area to Federal Reserve policies and operations in the late months of 1960 was about as much as could have been expected. Borrowing demands were light because of inventory curtailment and uncertainty as to future prospects. Yet total bank credit increased more than seasonally, as banks added to their holdings of Government securities and their loans to dealers in such securities. Demand deposits increased no more than seasonally, but time deposits showed a rapid rate of expansion.

While a greater increase in the money supply would have been desirable, any more vigorous measures to supply banks with reserves so as to encourage them to expand investments and thereby increase the money supply might have resulted in a further gold outflow, either because of low interest rates or for confidence reasons. In that event, such measures would not have served the intended purpose of promoting monetary expansion and stimulating domestic activity. Interest rates remained steady, and there was some expansion in overall liquidity. These achievements no doubt had some effect in moderating the intensity of the recession, which soon after came to an end.

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Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. I would like to take up for a minute the interesting dispute between Senator Bush and Congressman Reuss on what this chart means over here.

Did the remark and observation of Senator Bush, as I take it, indicate that as business improves and unemployment lessens, the reserve position become negative, that it drops down, of course, and it is possible, and I take it your position is that this is not because of any action on the part of the Federal Reserve, it is because of action on the part of the business community and the banking community in making loans and drawing on reserves; is that correct?

Mr. MARTIN. That is right; and I believe he pointed out what I have frequently pointed out up here, that rising interest rates have not been a sign of creating unemployment or poor business.

Senator PROXMIRE. I want to come to that in a minute. But this would mean that in the 1959, 1960, and 1961 period you have a period here of reserves being extremely low, highly negative, $500 million down, and yet unemployment being quite high, and it is your position, apparently, that there is nothing the Federal Reserve could do about it, it is kind of a rudderless ship, a cork on the ocean, it just floats along; whereas I understand the position of Congressman Reuss is that if the Federal Reserve wants to do it they can keep those reserves up. Whether this is going to have the effect of also keeping unemployment down we have yet to see because we have not tried it.

Mr. MARTIN. We have had pretty good evidence that inflation, a depreciation of the dollar, does not put people back to work, except for very temporary periods, and I do not think that you can remedy unemployment that way. The difficulty with these statistics, if you will forgive me for throwing this in—my favorite quotation that I frequently pass out, and it comes from Mr. Gilbert K. Chesterton—is that statistics should be used as a drunkard uses a lamp post, for support and not for illumination.

I think in this area that we are frequently, all of us, trying to fit these—and I include myself in this—fit these patterns into what our predilections are of what the answer may be.

I do not believe that this is a purely statistical matter, nor do I think that the Federal Reserve is as important as some people make it out to be.

I think we can have an influence, and we do have a stabilizing influence, but most people think we can fix interest rates whenever we want them, we can directly affect factors, and I just am convinced that we cannot do it.

Senator PROXMIRE. I am inclined to agree enthusiastically with your position against inflation, if you are getting down to that. As far as the ability of the Federal Reserve to fix interest rates, that also seems to me to be no question about that, although you say you cannot do it. It was certainly done during the latter part of the thirties, and all during World War II, under terribly adverse circumstances.

Mr. MARTIN. With disastrous experience.

Senator PROXMIRE. You can pay a very bad price, and it can result in inflation, it can be an extremely bad policy or a good policy, depending on your viewpoint. But it can be done, and was done, as a matter of historical fact, isn't that true?

Mr. MARTIN. I think it can be done at the price of inflation.

Senator PROXMIRE. You can peg the interest rates.

Mr. MARTIN. But that is what we all seem to agree we are against.

Senator PROXMIRE. But you can peg the Government bonds at par—you can do it—you can peg the Government bonds at par if you want to do it, and fix interest rates in doing so; isn't that right?

Mr. MARTIN. And what you come up to is what——

Senator PROXMIRE. I am not asking for that, I am just saying it can be done, so this is a matter of relativity, and since you can fix interest rates, you can certainly influence the course of interest rates quite decisively without going all the way at pegging bonds at par or anything of that kind, you can reduce interest rates; isn't this correct?

Mr. MARTIN. Yes, you can make some progress on it, but there is a limit to it. Zero is the limit and——

Senator PROXMIRE. All right.

I think we can also argue, perhaps, that the reserves, while they are in excess, we can say people can argue, at least, they are maldistributed.

Mr. MARTIN. Yes.

Senator PROXMIRE. And it is perfectly possible there are many banks that do not have adequate reserves, some banks in some communities.

Now, would you not agree that if the interest rate is reduced by, say, 1 percent for home mortgages, that where you have an instrument such as the administration has just suggested to put people to work and provide more homes with a no-downpayment, 40-year mortgage, that the resulting difference in payment between, say, $53 a month, with a high interest rate, and $46 or $47 a month with a lower interest rate, can result in a far more attractive opportunity for literally hundreds of thousands of American families, opportunities that translate themselves into more homes and literally millions of more jobs because of the fact that you not only have people building the homes but people behind those building the homes supplying the material that goes into the homes.

It seems to me to be the most explicit opportunity for monetary policy to put people directly to work. What is the matter with that?

Mr. MARTIN. I know one or two communities today where there are houses for sale, and the cost of money would not induce anyone to buy them.

Senator PROXMIRE. Well, isn't the cost of money though a big element certainly in a situation like this where you have no down payment and a 40-year mortgage, the interest rate, the biggest factor, it is more important than the cost of labor, it is more important than almost any element in payments on a home?

Mr. MARTIN. If you get to the point where you give houses away, of course, there is no limit to the demand. But if at certain prices you get an overbuilt situation—I do not say that is where we are, but in some places that is where we have gotten in recent years, an overbuilt situation—I question very much whether you are really stimulating housing construction or moving present houses off the market by just extending terms and getting people to go further into debt on them. That is a judgment of the market, of course.

Senator PROXMIRE. That is right. This is a new market, it seems to me, that you may not share, Governor, you may not share my en-

thusiasm for the program, but it does provide an opportunity for people with far lower incomes than ever before to have a new home and a good home because the monthly payment is so modest, and because the downpayment is nil and, therefore, the interest rate becomes so enormously important in this area.

Mr. MARTIN. Well, the reason I come back to interest rates on this, interest is a wage to the saver as well as a cost to the borrower, and we have to have savings if we are going to finance properly our community; and if you get more and more people convinced that savings are not of any value, and that you can just substitute bank credit ad infinitum for savings, you do not permanently put people back to work and keep them at work.

Senator PROXMIRE. Governor, you can destroy anybody's argument by making a reductio ad absurdum. I am not suggesting that you drive the interest rate down to zero at all. I think it has to be substantial, and I think considerably bigger than it was in the 1930's and 1940's, of course.

But I say it can also be substantially less than it is now, and provide a much better opportunity for home buyers than are offered at the present time, particularly with the unemployment situation and the idleness of our resources.

Mr. MARTIN. I am not disputing with you on that in certain places and conditions.

The point I am making is that we still have to depend upon accumulating savings, and that we cannot endlessly substitute bank credit for savings. That is the big problem that we have to deal with in the Federal Reserve.

Senator PROXMIRE. It seems to me the difficulty is that you interpret the President's remarks as suggesting that he was following through by a 5¼ percent FHA rate, and it seems to me this does not mean anything unless you have a general reduction in interest rates through the money supply, otherwise what happens, what has happened, again and again when the Government has tried to keep the interest rate artificially low with particular programs is that legally dictated low interest rates simply result in precisely compensated higher discounts.

The result is the home buyer paying exactly what he did before, and it just does not have any effect.

The only way you can get at this thing, it seems to me, is through the Federal Reserve Board. We can talk all we want to about doing it through all these other programs, but it is up to you to make these programs have effect.

Mr. MARTIN. I did not want to argue to the point of a reductio ad absurdum, but the reason I come back to savings is because the Federal Reserve Board can virtually—I am not saying that is what you suggest here—we can virtually print money by an endless purchase of Government securities regardless of the flow of money, which can just add unlimited amounts to the money supply.

I am talking about the money stream. You do not have to use taxes or anything else; you just take it away by printing or creating new money. That is the problem we are dealing with; and my checking account and your checking account at some point get involved in this.

Senator PROXMIRE. Can't I argue in return that what we develop, it seems to me, is artificially high interest rates inasmuch as there has been a tendency to maintain the money supply pretty much what it has been, while the gross national product has expanded with the result that you have a terrific tightening in the money market, and interest rates that would be higher than if we maintained, say, a 33- or 34-percent ratio between money supply and gross national product, instead of pulling it down from 50 percent at GNP in 1946 to 27 percent, which is about the present relationship.

Mr. MARTIN. I think that is right. I simply say that we ought to try to find the best equilibrating rate we can, but it has to be a rate—I use this word "equilibrating," because it provides for savings as well as for the creation of bank credit. That is the problem with which we are constantly dealing, and never once before this committee or any other committee have I ever said that the Federal Reserve hit it on the nose exactly.

We are an organization run by men like everybody else, but I say that, by and large, we have not done too bad a job of keeping in the center of this money stream.

Senator PROXMIRE. You see the difficulty is you keep saying that monetary policy cannot be the only instrument, I agree with you it should not be the only instrument to carry this terrific burden of taking care of the unemployment problem.

But I think you probably share with me a feeling that we cannot rely on deficit spending either, we cannot have—this is certainly inflationary—we cannot have a fiscal policy of unbalancing the budget deliberately now to achieve this, because this is going to have an inflationary effect, and it is bound to have an effect on the taxpayer which, I think, is going to be more obvious and more certain that any action that the monetary policy takes.

So if you say no dynamic monetary policy, at least none of the dynamism that Congressman Reuss and I advocate, and no compensation of fiscal policy, that is you must balance the budget, as a few of us maintain, then what have you got left?

Mr. MARTIN. Well, you put it very nicely there, and it gives me a chance to make my favorite speech on this subject, which is that monetary policy is only one of four factors. There is the budget; there is debt management and fiscal policy; there is the wage-cost problem; and there is monetary policy.

Now, I have insisted for some time that the principal handicap under which the Federal Reserve has operated the last 10 years—during the time I have been there—is that on many occasions people have conceded that budgetary policy is not all it might be, that management of the debt and fiscal policy has not been all it might be, and that very little has been done about the wage-cost problem, and at that point they say, "Ah, yes, here is one instrument we can really use regardless of whether these others are out of balance," and so they want to put the whole weight on monetary policy.

That is the point at where I think monetary policy does not permit—and we are talking in degrees here, because you and I are perfectly sincere in this, we do not want too high interest rates, we do not want too low interest rates, we want an interest rate that will be conducive to stability and growth in the economy—and it is the need for balance

among the four factors or components in the economy that is our major problem.

Senator PROXMIRE. Thank you very much. Thank you very much, Mr. Chairman.

Chairman PATMAN. Senator Pell.

Senator PELL. No questions.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Getting back to our chart, if I heard right, I thought I heard you say, Governor Martin, in your colloquy with our colleague, Senator Bush, that the unemployment curve on the chart is what pushed the reserves around rather than the other way round, which was the thesis I was propounding. Did I hear you right or——

Mr. MARTIN. I do not recall saying anything on that. I simply said that I agreed that there was something to the argument he was making. that during one period you had relatively stable levels of unemployment while monetary policy was on the tight side. I accepted his thesis and said that rising interest rates do not necessarily produce unemployment. Quite the reverse, rising interest rates have generally been a pattern of good business.

Representative REUSS. I see. Well, then, your exchange did not have anything, as far as I can see, to do with what you and I were earlier discussing, namely, free reserves. I wanted to make sure absolutely of that in my own mind. To do that, let me ask you this question: There is no doubt, is there, that what the Federal Reserve and Open Market Committee do, affects whether the banking system has a net free reserve position or a net borrow position?

Mr. MARTIN. Unquestionably we have some effect.

Representative REUSS. No doubt whatever about that, is there?

Mr. MARTIN. We have some effect, yes. We would not be in business otherwise. But this is the matter of control as against guidance.

Representative REUSS. Right. But there is no doubt whatever of the ability of the Federal Reserve to govern the level of bank reserves. There are many other factors, but you have the residual power through open market policy, rediscount rates, and bank reserve requirements to set the level of bank reserves and to will whether they shall be a net free balance or a net borrowed balance, is that not so?

Mr. MARTIN. We can certainly affect the volume of reserves. Whether or how people use those reserves is not in our control.

Representative REUSS. Exactly.

On this question of the automatic stabilizer that I was trying to set up between you and me, I have instituted certain administrative arrangements in the last few minutes, and you will be glad to know that I have made arrangements so that I will be informed whenever the free reserves setup by the Federal Reserve System go markedly below the present half-billion-dollar figure, and if that should happen before our unemployment problem is substantially resolved, and I devoutly hope that we will not see a lowering of free reserves much below the 500 million level until the unemployment problem is much more in hand, I then would want to communicate with you and to discuss the matter. Do you see anything wrong with that?

Mr. MARTIN. I am always glad to discuss with you at any time, Mr. Reuss, and that goes for any member of the committee.

Representative REUSS. You will present the point of view I have presented here, and the rather remarkable parallelism between the free reserve position and the unemployment curve, to your colleagues on the Federal Reserve Board and the Open Market Committee, so that they may take them into account?

Mr. MARTIN. We will see that this record is given to every member of the Board and the Open Market Committee.

Representative REUSS. Well, I was asking for a little more from you. I was actually asking that you call this particular chart to their attention so that they may ponder what I have been pondering, ask themselves whether maybe monetary policy has not been contributing to our troubles and whether there ought not to be more free reserves maintained longer. Would you do that?

Mr. MARTIN. We will be very glad to do that, Mr. Reuss.

Representative REUSS. Thank you very much. Thank you, Mr. Chairman.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. As I understood you, in the answer to my previous question, Governor Martin, you said that there had been an increase in reserves owing very lragely to a reduction in reserve requirements, at least there had been a 10-percent increase in reserves that flow from a reduction in reserve requirements. Did I misunderstand you?

Mr. MARTIN. And open market operations, too, Senator.

Senator PROXMIRE. Yes.

Mr. MARTIN. We are covering the period now from May 1 a year ago to June 1 today.

Senator PROXMIRE. That is right. Can you tell me which instrument the Federal Reserve Board used primarily?

Mr. MARTIN. I would say that the open market operations were the most important, Senator. But because of vault cash—you remember the 1959 legislation that Congress enacted?

Senator PROXMIRE. I remember that. I was the sponsor of that.

Mr. MARTIN. The permission to count vault cash toward reserves and the equalization of reserves between central reserve city and reserve city banks and related changes under that legislation contributed, I would say, about 40 percent. I would have to check that figure.

Senator PROXMIRE. That would be 40 percent reserve requirements and the other 60 percent——

Mr. MARTIN. I think so, that is right.

Senator PROXMIRE. Over the past 10 years would you say this has been about the proportion or have lowered reserve requirements been a larger element?

Mr. MARTIN. No. I would say—I would not know over the last 10 years. I can get that and put it in the record for you.

(The following statement was supplied for the record by Chairman Martin:)

FEDERAL RESERVE ACTIONS AS TO SUPPLY OF BANK RESERVES

From mid-1959, when credit demands were exceptionally heavy and Federal Reserve policy was directed toward restraint on further bank credit and monetary expansion, until the present, when credit demands are relatively light and policy is directed toward increased availability of credit, the reserve position of

member banks shifted from substantial net borrowed reserves to a high level of net free reserves. During most of 1959 net borrowed reserves exceeded $500 million and in 1961 net free reserves have generally exceeded $500 million.

This change, in a period when a gold outflow exerted a drain of $2.8 billion on bank reserves, was possible because of Federal Reserve actions to make reserves available to member banks. Federal Reserve actions included an increase of $800 million in Federal Reserve holdings of Government securities and authorization for member banks to count about $2,400 million of vault cash as reserves, in effect a decrease in reserve requirements. The effect of a decrease in requirement percentages at central reserve city banks approximately offset the effect of an increase in percentages at country banks, made in connection with the vault cash action.

Over the past 10 years from May 1951 to May 1961, Federal Reserve actions to supply reserves included a net increase of $4.3 billion in System holdings of Government securities, reductions aggregating $4.2 billion in member bank reserve requirements, and the $2.4 billion of vault cash that banks were permitted to count as reserves. This total of about $11 billion, together with some Treasury release of gold and issuance of silver certificates over the period, covered an increase of $4.2 billion in reserves needed to be held against the growth in member bank deposits, a $4.7 billion expansion in currency in circulation, and a net drain of $3.7 billion resulting from gold and other foreign transactions.

Senator PROXMIRE. The reason I am proceeding on this line of inquiry is this morning I discussed with Mr. Hayes the difference in these two instruments. I asked him why it would not be good public policy to prefer open-market operations to reserve requirement since the open-market operations resulted in the purchase, in effect by the Government, of Federal obligations. This results in retiring the national debt and a far better situation for the taxpayer. Increasing reserves through lowering reserve requirements in beneficial to the banking community and, perhaps, is necessary sometimes. But this policy is not as beneficial to the public generally.

Mr. MARTIN. Well, that has been pointed out. We have gone into this before, as you know. During the wartime period and immediately after, in my judgment, we got inordinately high reserve requirements. There were many reasons for that. One was that you had a number of specific controls and not just general controls, and one of the specific controls was to put reserve requirements up. But we found that did not work very well because we could not control the use of those reserves. They just dumped the Government bonds onto us, so that it was not a very effective instrument in that way.

Now, what the Board will do in the future—and reserve requirements are under the Board not the Open Market Committee, you see—with respect to the use of these instruments I cannot say. But I certainly believe that we have to have access to both instruments because I do not think you can foresee what the conditions are going to be. It might be that we have latitude between the so-called country banks and the other banks for working on this reserve thing, and it might be that one time we would want lower reserves, but we will bear in mind your point about the portfolio.

Let me make one point on the portfolio, though, that comes into this. The portfolio of the Federal Reserve System is not an investment portfolio where we ought to be putting our maturities into the picture like an investor.

What we are trying to do is to get a better maturity distribution of the Federal Government debt. To just sell securities to the Federal Reserve accomplishes nothing toward that end—I am talking now about the long and the short. I think the reason that a central

bank should have as liquid a portfolio as it can have, does not mean that it all has to be in the short end of the market. But we are not in the business of making profits or making a permanent investment; and we want the Federal Government, in maturities and distribution, to get away from being constantly at the mercy of the market and to have more long-term securities out; and we want those long-term securities purchased not by the Federal Reserve but by nonbank investors out of savings; that is one of the principal ways of having sound financing of the Federal debt.

Senator PROXMIRE. Yes. But you have this very small proportion of about 10 percent, less than 10 percent, of your portfolio in more than 5-year, and 90 percent in less than 5, and most of it in less than 1.

Mr. MARTIN. I think that is what the central bank portfolio should be.

Senator PROXMIRE. Well, it seems to me that the arguments you have just given me now are not nearly as telling as just the two simple arguments—No. 1, that you save money for the taxpayer by investing in long-term obligations which generally are higher yielding, rather than short-term obligations which generally yield a great deal less; and No. 2, the fact that as far as impact on the economy is concerned, it is the long-term interest rate for homebuilding and for other things which is the more important in terms of expanding the economy and moving ahead. So purchase of long-term securities is more beneficial to the economy. And then No. 3, of course, you have the perfectly obvious argument now on gold outflow, which I think is very telling, but it may be just temporary.

Mr. MARTIN. Yes. But let me point this out——

Senator PROXMIRE. These are solid arguments, not arguments about how a central bank ought to be liquid without limiting it to any specific reason.

Mr. MARTIN. Well, we have made an adaptation because of the gold outflow. You see, that is why we have engaged in our current operations. But the purpose of a central bank portfolio should not be to pick up sales of the Federal Government to itself—that is what it would be—of long-term obligations, because you want those long-term obligations placed in the hands of bona fide nonbank investors. This gets back to my point of not substituting bank credit for savings. And one of the problems we faced in 1959 was the fact that with the deficit that arose, unless the Federal Reserve was to buy all of the securities, whether they were short, intermediate, or long, you had to get slightly better interest rates or you were not going to get any buyers.

Now, we succeeded in financing a large portion—10 to 12 billion—of the debt that was incurred in that period, through purchases by nonbank investors, which is about as solid finance as I think you can get. I believe it has been very beneficial, and perhaps it laid the base for the recovery that we all hope we will have now.

Senator PROXMIRE. Now, I just have one other question, and this is a technical matter. Mr. Hayes this morning said that one of the reasons for using the reduction of reserve requirements instead of open market operations is that it has a quicker effect, the lag is less, that you can provide reserve requirements more readily, that there is a tendency, if the Fed buys Government securities, it takes some time before the national reserve requirement of the bank reserves increase.

Now, he did not have any study to corroborate this, or any statistical information, although he thought there might be some, and he said he would supply a memorandum.

I am wondering if the Fed, in your knowledge, has made any study. This seems to me to be so important to an effective open market operation, that there should be some better notion of it than just a feeling that maybe it is preferable.

Mr. MARTIN. We have made several studies of that. I can put something in the record on it. I think the main point there, Senator, is that if you make a reserve requirement reduction, then every bank in that class gets the reduction immediately.

(Mr. Martin, jointly with Mr. Hayes, p. 78 supra, supplied the following memorandum:)

RESERVE REQUIREMENT CHANGES AND OPEN MARKET OPERATIONS: QUICKNESS OF EFFECTS

When the Federal Reserve System is considering the choice of one instrument or another as the means for increasing the availability of bank reserves and fostering monetary expansion, one of the considerations is the speed and thoroughness with which the influence will be transmitted throughout the banking system, although this consideration may or may not be of prime importance in any given situation. It has been pointed out that a reduction in reserve requirements can have a widespread effect very quickly and that this may at times be a reason why such a reduction, rather than open market purchases, would be the preferable form of action.

The purpose of the present note is to discuss the quickness of effects of these kinds of Federal Reserve actions. The discussion is restricted to a comparison of alternative means of increasing the availability of reserves, especially since Federal Reserve actions to reduce reserves are practically always directed toward absorbing redundant reserves being made available by market developments and never toward forcing a net contraction in credit.

It is impossible to trace exactly the effects of any particular System action affecting the supply of reserves, because the secondary and subsequent consequences of the flow of reserves and money throughout the financial structure are very much greater than the immediate effect of the initial action upon the banks first affected. Most Federal Reserve open market operations, furthermore, are in response to short-run market developments or pressures and are thus directed toward offsetting fluctuations in reserve availability that would otherwise have occurred due to market forces.

A change in their reserve requirements affects with unquestioned speed the reserve position of all member banks to which it is applicable. An open market operation also tends to affect the reserve positions of a great many banks rather quickly. It reaches most country banks indirectly, however, and there is room for difference of opinion as to the speed and pervasiveness with which the effects are transmitted to them.

Open market operations ordinarily affect, in the first instance, the reserve balances of so-called money market banks in New York and other financial centers. Through them the effects are quickly transmitted to the money market in general. This is true because these larger banks, which deal actively in money market instruments such as Federal funds, Treasury bills, and other highly liquid paper, undertake to keep their available funds fully invested by buying such instruments whenever other credit demands do not completely use up their available funds. Many banks, especially country banks, do not attempt to keep all their funds continuously invested in this manner. Hence, changes in their reserve position may have less immediate impact on the market, although such banks, in adjusting their reserve positions, may affect the money market, particularly through shifts in their balances with city correspondents. The flow of reserves to or away from country banks is determined largely by the activities of their customers, depositors, and borrowers, rather than by money market developments.

When a reduction occurs in reserve requirements for all classes of member banks, every member bank immediately has more funds available for lending or investing (or for reducing its indebtedness to the Federal Reserve System).

In the case of money market banks, this tends to produce an extremely rapid response in terms of expansion of their loans and investments as would also be the case if the Federal Reserve action took, instead, the form of open market purchases.

On occasions when it is especially important that the effects of a Federal Reserve action influence the reserve positions of country banks as rapidly and as pervasively as possible, this would be a factor that would favor a change in the reserve requirements. On the other hand, country banks do not put newly released reserves to use as rapidly as money market banks, so that if a quick money market response is needed, open market operations would be preferred. Of course, the matter of relative promptness is only one consideration, and not necessarily the decisive one, dictating the choice of instrument.

There are three main ways in which a country bank may respond to a reduction in reserve requirements. The bank may, of course, immediately make new loans (if there is a demand for loans) or acquire additional investments. Second, it may increase its balances with its city correspondent banks. The city bank receiving such deposits would typically be one that is active in the money market; it could therefore more readily put the additional funds to work until such time as the country bank might withdraw them in order to increase its own loans or investments. In either of the foregoing cases the total loans and investments of the banking system, and hence normally the money supply, are increased. Third, the country bank may simply leave its funds temporarily in the form of excess reserves at its Federal Reserve bank or it may use the funds to repay indebtedness at the Reserve bank. If it does either of these, there is no immediate increase in bank credit or money.

Analysis of member bank data indicates that on each occasion when the reserve requirements of country banks have been reduced, there has been a substantial temporary increase in their excess reserves. In the case of some banks, there were periods ranging up to several months during which the reduction in requirements was reflected mainly in excess reserves rather than in actual expansion of loans or investments.

Nevertheless, in this case as in the cases where the funds were immediately invested (either directly or through correspondent banks), the banker had a feeling of greater "ease" because he was in a position where he could more readily expand his loans or investments whenever any attractive opportunity might present itself. Furthermore, despite the temporary increases in the total excess reserves of country banks at times when reserve requirements have been decreased, more than half of the reserves released to these banks have usually gone into loans or investments or correspondent balances within a month from the date of each release.

If the additional lending power is made available instead by means of Federal Reserve open market purchases, rather than by reducing reserve requirements, the additional reserves tend to flow initially into money market banks, because these banks buy and sell money market instruments themselves, carry the accounts of other large investors whose transactions are important in this market, and also handle the financing of the securities dealers (to whom the Federal Reserve makes payment in the first instance). The money market banks tend to put their added reserves to use quite promptly, either by reducing their borrowings or by expanding their loans and investments from the level that would have prevailed in the absence of such Federal Reserve operations.

Such speedy response is facilitated by the normal channels of operations of the financial system, which tend to funnel net excesses of supplies or demands for funds from all parts of the country into the money centers. Added reserves that are received by money market banks are thus redistributed to other banks. This may occur directly, if the money market banks repay borrowings or buy securities from other banks or increase loans to them. Otherwise, the reserve redistribution will be indirect, as the money market banks increase loans to, or purchase securities from, nonbank customers, with a resultant prompt increase in the deposit liabilities of those banks and hence in the total money supply.

Such an increase in the money supply is normally accompanied or followed by an outflow of funds from money market banks to the rest of the banking system. These payment flows increase bank balances of many persons and firms engaged in economic activities everywhere, and hence affect all the banks in which they keep their accounts. The effect on individual banks, especially country banks, is indirect and not susceptible to accurate measurement, nor does it necessarily affect every bank. When a country bank's position becomes "easier" due to its having an inflow of deposits, the banker himself is normally unaware that this condition may be related to the Federal Reserve operation.

Because of this, the banker would not know whether or not he could expect the added funds to stay in his bank, and hence he might be hesitant about investing them in anything that could not be liquidated quickly if necessary. If his condition of relative ease had arisen instead from an announced reduction in reserve requirements, he might expect that this would not be reversed soon by an increase in the requirements and might therefore expand his loans with more confidence.

The foregoing discussion relates mainly to System moves to supply reserves for the purpose of exerting direct influence on bank credit in the direction sought by System policy. In other words, if the System's overall policy should call for monetary expansion this would presumably be accomplished under varying circumstances by open market purchases or, alternatively, by lowering reserve requirements with the results described, or by coordinated use of both. Consideration must be given, however, to the System's objective of smoothing out the peaks and valleys in reserve availability so as to keep bank reserve positions and the tone of the money market consistent with the System's broader objectives of ease or restraint. This may at times require short-run moves in a direction contrary to longer run System objectives. For example, when market factors temporarily supply excessive amounts of reserves, the System may sell securities to mop up some of the excess, even though basic policy calls for monetary ease.

This continuing objective is carired out through day-to-day open market operations. Such operations provide the requisite flexibility in direction and timing, in addition to which it is possible, through judicious use of repurchase agreements, as well as outright purchases and sales, to direct operations toward particular areas of the money market as conditions may require.

Senator PROXMIRE. You have no maldistribution.

Mr. MARTIN. There is no maldistribution. This is the point of maldistribution that we raised earlier.

Now, we have quite a bit of maldistribution of reserves in the banking community, for one thing because of the different holdings of vault cash, and there is the new vault cash experience which has come in. The adjustments of reserve requirements at certain periods over the last 10 years, during the time I have been with the Board, have, to me, been very effective at given points because they did not face any maldistribution. Everybody got something right away.

Senator PROXMIRE. Is it not difficult because it is not reversible? At least it is very difficult to reverse it. In other words, if you raise reserve requirements, then you have—you penalize some banks that are in a position where they are trying to serve their community as widely as they can and other banks happen to have excess reserve, they enjoy a benefit. So you can move smoothly in only one direction, is that not right? Does that not suggest some caution?

Mr. MARTIN. That has been one of the reasons that we have given. I am not absolutely certain, to be completely honest with you, that that is always a bona fide reason. In terms of political repercussions from the community, it is. But in terms of being effective on what you are trying to do, it is always a debatable point. But I think it is much easier to reduce them than it is to raise them, because you then have the maldistribution on the side of paying as against whatever maldistribution there might be the other way on the side of ease.

Senator PROXMIRE. My final question is perhaps out of bounds, Mr. Chairman. I do not know. But the Governor of the Federal Reserve Board made a very persuasive and telling case in favor of explaining much of the unemployment on the grounds that it was structural, and saying that increase in demand may not be the most satisfactory or complete answer, at least.

I am wondering in light of that if you have any views on the President's recent recommendation of a bill that would provide training for hundreds of thousands of people who need skills in order to find jobs, and is directly aimed at structural unemployment. Do you feel that kind of approach—I do not ask you if you support or oppose the bill—can help reduce unemployment?

Mr. MARTIN. I do, indeed. I think it is a very useful approach, and one that ought to be pursued as vigorously as possible. As you suggest, however, I have not studied the bill per se.

Senator PROXMIRE. It would be quite an expensive bill, because it provides for subsistence for these people while they are being trained. It provides for transportation. It is quite an ambitious bill. It involves hundreds of thousands of people. He is sending it to Congress this week.

Mr. MARTIN. I think it is very important to do that. And also I think it is important in communities where you have got structural unemployment, where technology has run ahead of things, to try to bring business to the community as well as move people away from the community. It is a whole lot easier to try to move the business in where there is unemployment.

Senator PROXMIRE. We have our area redevelopment bill, which is quite modest, but it is aimed at that.

Mr. MARTIN. Yes, that is right. I am all for that.

Senator PROXMIRE. Thank you, Mr. Chairman.

Chairman PATMAN. I want to cover one point, Mr. Martin, and that will be all that I will care to ask you.

In your statement, in the annual report for 1960—and I want to congratulate you for getting it up earlier this year—it is earlier than usual—has been very helpful.

Mr. MARTIN. And we give you credit for that, Mr. Patman.

Chairman PATMAN. Thank you, sir. I am glad that I have a nuisance value.

The capital paid in indicates $408,709,000. It is a coincidence, I know, but the surplus is almost exactly twice that much, a difference of less than $20,000—$817,423,000.

Now, my question is, Why can you not pay that and why do you not pay that into the Treasury? I recall one time that after voluntarily paying in a lot of money which from time to time amounted to a considerable amount you put in about $266 million at the end of the year, just to help on the Federal budget. Now, the budget is still in bad shape, Mr. Chairman. Why can you not pay this surplus fund?

Mr. MARTIN. Mr. Patman, the $266 million was not just to help on the budget, as I've explained before. But we are now paying over these amounts into the Treasury 100 percent. Now, we stop at this particular level. And the payment you are referring to was over and above this particular level.

Now, of course, we do not have—we have been over this before—we do not need any capital or surplus at all.

Chairman PATMAN. You don't need either one of them.

Mr. MARTIN. You can eliminate them all. The banks don't need any capital either.

Chairman PATMAN. You do not use them. They are not invested. They do not serve any purpose.

Mr. MARTIN. I think they do serve a purpose.

Chairman PATMAN. Well, name one.

Mr. MARTIN. Well, one, if we were liquidated this would come to the Government.

Chairman PATMAN. Certainly.

Mr. MARTIN. But we are not in process of liquidation at the moment. And I think it is very desirable that we have an accounting system which is understandable and which is traditionally the accounting system on which——

Chairman PATMAN. It is comparable to a corporation. That is the only argument I have ever heard. It is kind of like small boys and girls playing papa and mama. But really it serves no purpose, the funds are idle, they are not invested, and you are paying the banks about $23 million a year interest for nothing.

Mr. MARTIN. No, I think it serves a very real purpose.

Chairman PATMAN. Well, I will not go into it further. You have always answered my questions in a forthright manner, which I appreciate but most any question I could ask of you I could turn back and find an answer somewhere in the hearings we have conducted in the past.

Mr. MARTIN. That is right.

Chairman PATMAN. I want to thank you, as Chairman of the Board of Governors and Open Market Committee for appearing and giving us the benefit of your testimony. We appreciate it, you have been helpful.

Mr. MARTIN. Thank you.

Chairman PATMAN. Without objection, each member will be allowed to extend his remarks.

The committee will stand in recess subject to call of the Chair.

(Whereupon, at 4 p.m., the committee took a recess, subject to the call of the Chair.)