416

[COMMITTEE PRINT]

90TH CONGRESS
2d Session

SENATE

REPORT
No. —

STANDARDS FOR GUIDING MONETARY ACTION

REPORT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

TOGETHER WITH

SUPPLEMENTARY VIEWS

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
95-443 O WASHINGTON : 1968

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

WILLIAM PROXMIRE, Wisconsin, *Chairman*
WRIGHT PATMAN, Texas, *Vice Chairman*

SENATE

JOHN SPARKMAN, Alabama
J. W. FULBRIGHT, Arkansas
HERMAN E. TALMADGE, Georgia
STUART SYMINGTON, Missouri
ABRAHAM RIBICOFF, Connecticut
JACOB K. JAVITS, New York
JACK MILLER, Iowa
LEN B. JORDAN, Idaho
CHARLES H. PERCY, Illinois

HOUSE OF REPRESENTATIVES

RICHARD BOLLING, Missouri
HALE BOGGS, Louisiana
HENRY S. REUSS, Wisconsin
MARTHA W. GRIFFITHS, Michigan
WILLIAM S. MOORHEAD, Pennsylvania
THOMAS B. CURTIS, Missouri
WILLIAM B. WIDNALL, New Jersey
DONALD RUMSFELD, Illinois
W. E. BROCK 3D, Tennessee

JOHN R. STARK, *Executive Director*
JAMES W. KNOWLES, *Director of Research*

ECONOMISTS

WILLIAM H. MOORE
RICHARD F. KAUFMAN
JOHN B. HENDERSON
ROBERT H. HAVEMAN
GEORGE R. IDEN
DONALD A. WEBSTER (Minority)

CONTENTS

	Page
Introduction	1
I. Monetary and fiscal policies are not alternatives but must be coordinated	3
II. The "Fed" can effectively control the size of the money stock	5
III. The effects of Federal Reserve action are felt over a long time interval	8
IV. Even a discretionary monetary policy needs direction and evaluation	10
V. A set of projections and rules for monetary action, with opportunity to explain deviations, would be better than no guidelines at all	16
Findings and recommendations	19
Supplementary views of Representative Patman	21

90TH CONGRESS 2d Session } SENATE { REPORT No. --

STANDARDS FOR GUIDING MONETARY ACTION

JUNE —, 1968.—Ordered to be printed

Mr. PROXMIRE, from the Joint Economic Committee, submitted the following

REPORT

together with

SUPPLEMENTARY VIEWS

[Pursuant to sec. 5(a) of Public Law 304, 79th Cong.]

INTRODUCTION

Under the Constitution, the Congress has been given the responsibility for determining matters involving coinage and the stock of money. The Congress has chosen to delegate the exercise of this authority to the Federal Reserve authorities, giving them a considerable degree of independence both from the Congress and from the Chief Executive. For their part, representatives of the Federal Reserve System have repeatedly acknowledged before the Joint Economic Committee and elsewhere that the Declaration of Policy contained in the Employment Act of 1946, along with the Federal Reserve Act itself, provides in broad and general terms directives for their guidance. Discussion persists, however, as to whether such broad language of the Employment Act is adequate or sufficiently specific to serve as guidance for the Federal Reserve authorities, acting as the monetary agent for Congress.

NOTES

[Due to pressure of other responsibilities, Senator Fulbright was unable to participate in the hearings and other committee deliberations pertaining to this report and reserves judgment on the specific recommendations made therein.]

[Senator Symington states: "Because of unusually heavy commitments in connection with other committee responsibilities, I was unable to participate in all the hearings on which this report is based; therefore I do not wish to endorse it."]

For its part, the Joint Economic Committee has heard much evidence over the years on the role of monetary policy and, in its recent annual report, has made some specific policy recommendations. Nevertheless, there remain some very difficult unsettled questions about monetary management. Some of these arise from our experience of credit scarcity in the "credit crunch" of late 1966. Most of them have to do with actual operations and market responses, rather than with theory.

This report, relying heavily upon the testimony at our hearings on May 8, 9, 15, and 16, 1968, and in many cases making use of the language of the expert witnesses, is directed especially at the following issues:

(1) What are the interrelations between monetary policy and fiscal policy and to what extent can they be regarded as alteratives?

(2) Is the monetary authority able accurately to manage the stock of money, however money may be defined?

(3) How do actions taken by the monetary authorities work their way through the financial markets to affect interest rates and the stock of money?

(4) Has the Congress been sufficiently explicit in providing guidance to the Federal Reserve authorities—its agent in monetary management?

(5) What considerations would be most appropriate and most helpful as guidelines for monetary action?

I

Monetary and fiscal policies are not alternatives but must be coordinated

An overall objective of both fiscal and monetary policy is to keep total spending, public and private, in such balance with the output of goods and services as to maintain a high level of economic activity at stable prices. Monetary policy can limit total private spending by having private credit demand accommodate to Government credit demand. However, it cannot limit Government spending, which comprises a sizable part of the total. Fiscal policy can limit Government spending, but its effects on private spending may be either supported or largely frustrated, depending upon debt management and the choice of a concomitant monetary policy. Under most economic conditions, fiscal and monetary actions are thus complementary, not alternative, instruments and should be used together as parts of a coordinated economic policy.

For example, if the executive branch, acting under authorizations from the Congress, were to undertake a large increase in spending, and if at the same time the Congress did not assure adequate tax revenues, there would be a large increase in the budget deficit, which the Treasury would have to finance by offering new U.S. Government securities for sale. Fiscal policy, in this case, would require monetary action to accommodate management of the Federal debt.

Conceivably, the nonbank public would be willing to acquire all of the new debt offered without change in the Treasury's terms of offer, in which case the monetary authorities would have to cope with the consequences of a lower supply of funds loanable to the private sector. More probably, the Federal Reserve System would be required to act through open-market operations in Federal Government securities.

Thus the Federal Reserve has a choice when faced with a Treasury deficit: the Federal Reserve can increase the money stock as a side effect of open-market purchases while maintaining interest rates about the same, or hold the money stock fixed while permitting interest rates to go up. Of course, one could choose a policy somewhere between these two; that is, permit some increases in both the money stock and interest rates. But the Federal Reserve cannot stabilize both the money stock and interest rates in this situation.

Similarly, when faced with a Treasury surplus, the Federal Reserve has a choice between stabilizing the money stock while interest rates fall, or stabilizing interest rates while the money stock falls, but cannot stabilize both.

Although the Fed, as we shall see, can control the stock of money within limits, as a practical matter its choice in doing so must inevitably give great weight to the reality that the Federal Government's needs for credit cannot and will not be denied. The money needs of the sovereign will be served even though this may mean higher interest

rates to other would-be borrowers competing for restricted funds, or by an expansionary policy resulting in an inflationary levy upon investors and consumers.

The policies that regulate money and credit availability and use, as well as the policies controlling debt management operations and the expenditures and receipts of the Treasury, are all integral parts of an overall combination of policies. When the President, the Congress, and the Treasury have decided on a particular combination of expenditure and tax policies, they have already determined the magnitude of the Treasury's debt management operations, and by this channel have decided in large part the limits within which monetary policy will operate. If, as in fiscal year 1968, a deficit of over $20 billion has to be financed, and this makes up a high proportion of the total of new credit sources, then clearly the Federal Reserve System and its managers are limited either to buying enough Treasury securities in the open market to facilitate absorption of the residue of this huge addition or, alternatively, to inducing a very sharp reduction in funding of private requirements.

II

The Fed can effectively control the size of the money stock

It was evident that if the committee were to outline a number of guidelines for monetary actions of the Federal Reserve System, they should be within the effective control of the monetary authority. Targets have no meaning if the range of inaccuracy is too wide or if the constraints that have to be reckoned with are too numerous or too confining.

The testimony of witnesses in the recent hearings showed a large degree of agreement in speaking to these issues. The obligation of the monetary authority to keep financial markets functioning and to maintain the quality of the Federal Government's debt were recognized as constraints that, on occasion, acquired the status of priorities. In particular, as noted above, the severe burden imposed on the monetary authority by the growth of the Federal budget deficit in 1967 reduced the options of the monetary policymakers.

It was noted, moreover, that private-sector demand—and in particular corporate demand—for liquid assets to hold as protection against foreseen and unforeseen needs was not under the direct control of the monetary authority. Rather, it was indirectly influenced by the results of monetary actions and, in particular, by the interest foregone in the choice to hold demand deposits. Thus the so-called credit crunch of 1966, when the availability of credit, at any cost, was for a time sharply and embarrassingly reduced, was widely viewed as an important cause of the broad corporate policy of building up liquidity in 1967. While the acceleration of corporate tax payments was a contingency that the Federal Reserve System could provide for, on a reasonably accurate quantitative estimate, the identification of the temporary surge in demand for money—money that was intended to be kept, rather than to be spent, and thus to generate an increase in the credit flow—was not easy. Moreover, there was no assurance that this abnormal increase in the money supply would not, at some future date, be used to fuel an inflationary increase in credit.

This particular example was held up as typical of the dilemma that regularly faced the Federal Reserve System. On balance, a majority of the witnesses felt that in 1967 monetary policy had been circumspect and, in view of the fiscal limitations, as moderate as could have been devised. That feeling, however, was not shared by those who emphasized the importance and the future potential of a very large increase in the money supply.

The sole conclusion was that the choice of tempering the surge of interest rates was explainable, whether or not with approval, as an exception to a rule of stable growth of money supply and as a concession to an increase in the demand for money, despite the inflationary potential.

95-443 O—68——2

As a less important factor in the calculation of the Federal Reserve System, member banks' initiative in changing the level of their borrowings from the System could in the short run change the money supply from the intended level. Yet the control of the discount window was recognized as an effective means of limiting any longer-run deviation from the monetary authority's intent.

The consensus of the witnesses, with which the committee agrees, was that in normal times and with few exceptions, the Federal Reserve System could, if it chose, reach with reasonable accuracy any given preferred level of money supply, within a range of sensible and responsible action. The money supply might be defined narrowly as currency in circulation plus demand deposits adjusted to exclude interbank and governmental accounts; it could be defined broadly to include also time deposits; or it could be replaced by the Federal Reserve System's credit proxy—a limited measure of demand deposits including, however, governmental accounts. In each case, the targets could be reached in normal times and within a narrow range.

Given that the Federal Reserve System can usually control the quantity of money, the question arises how the public would use it. On this, the quantity theorists base their prescriptions on the view that moneyholding is a relatively constant aspect of economic performance; the velocity of circulation of a given money supply, or its rate of turnover in meeting monetary obligations, they argue, would not vary significantly if there were no disturbances induced by changing monetary policies.

Other witnesses were less prepared to accept the downgrading of velocity as a financial reality. In the short run, for example, the wish of the public to hold money balances is clearly affected by the alternatives available. In particular, the cost of holding demand deposits is the interest that might be earned on holding other assets. A high interest rate would, therefore, lead to efforts to reduce the level of demand deposits, making a given amount of money circulate faster. The behavior of moneyholders might depend, moreover, on expectations, degree of uncertainty, and liquidity targets.

Two observations are in order. The Federal Reserve System bases a large part of its case for discretionary leeway on the grounds that short-run changes in market behavior are not predictable. Secondly, the greatly increased variety and quantity of interest-yielding and relatively liquid assets that can serve as alternatives to noninterest-yielding demand deposits has in the past three decades introduced a new complexity into the analysis of money-holding and money-velocity. Hopefully, research in progress and improved analysis will help us understand people's choices and hence the role of velocity.

The functional exceptions to the Federal Reserve System's control of the money supply were associated with severe pressure from Federal Government demand for credit to accommodate public needs—a demand which, unlike private demand, could not ordinarily be suppressed. Secondly, there was the swift, often unexpected variation in private liquidity needs.

The historical exceptions to the Federal Reserve System's ability to control the money supply were mostly presented by other witnesses as examples of the perversity of Federal Reserve policy in circumstances over which it had perfectly adequate control. In either evalua-

tion, these examples appeared to have only limited contemporary relevance. Thus there was a contraction of money supply by one-quarter between mid-1929 and mid-1933; while banks with loanable funds chose to restrict their business because they saw no chance of coping with lending risks, this was a result of persistently erroneous Federal Reserve policies. Again, the fantastic doubling of banks' required reserve ratios in 1936–37, accompanying a check to the growth of money supply, precipitated trouble in money markets and in the economy. So, it could be said, it was the loss of confidence, the malfunction of the credit markets and the relative cheapness of money holding, especially when prices were falling, a situation compounded by the incapacity or harmfulness of Federal Reserve policy, that should be held responsible. More recent experience too, for example, the vagaries of Federal Reserve policies in the late 1950's, shows how wrong it is to ascribe limitless perspicacity to any human institution. Nonetheless, the committee is of the view that the management of the entire economy, still beset by imperfections and uncertainties, has at least developed to the level of never again having to undergo or tolerate such a vast monetary and economic disorder as the depression of the 1930's.

III

The effects of Federal Reserve action are felt over a long time interval

The processes by which Federal Reserve policy affects the economy are complex and indirect. Nevertheless, there was virtual unanimity in the recent hearings that a steadily growing economy with stable prices was likely to be best assisted by a comparable steady growth of money supply. It would also be natural to expect that the monetary authority would wish to adhere to such policy in the absence of disturbance.

To say that steady growth in the money supply is a necessary condition for the maintenance of general economic stability and growth is, however, not to say that a policy of creating steady growth in the money supply will be sufficient to induce steady growth in the economy.

This critical issue was examined by the Joint Economic Committee in terms not only of rules of conduct for monetary policy, but also in terms of the pattern of changes that could be expected to follow actions by the Federal Reserve System.

Subject to the demands of the Federal Government for support and to the short-term variations in discounting for member banks, the Federal Reserve can make a firm decision on the creation of its own credit. It has therefore good control over the maximum availability of credit for the private sector. The willingness of the commercial banks to lend or of businesses and persons to borrow merely sets the terms on which financial deals are transacted.

The pattern of interest rates, then, is to be regarded as an outcome of a large number of forces of supply and demand to which the open market operations of the Federal Reserve System contribute a very powerful influence.

The strength of these forces and the market responses they set in motion can be estimated in a general and not very accurate way, but cannot be surely forecast. The capacity of the monetary authority to achieve a chosen pattern of interest rates is therefore substantially less than its control over the supply of money or of bank credit. For this reason the committee endorses the recommendation of one witness who regarded interest rates as generally an unsuitable major objective of monetary policy action.

Nevertheless, there are differential impacts on different sectors of the economy resulting from changes in interest rates. It is clear therefore that the monetary authority, in adhering to some policy rule—for example, of steady growth of money supply—cannot wholly ignore the side effects of such a policy on the pattern of interest rates. The monetary authority cannot be indifferent if its policy threatens to create such stringency that the mortgage and municipal bond markets verge on collapse. Nor can it ignore the deterioration of monetary contracts in any important market.

The committee recognizes that in tempering the pressures of rising interest rates, the Federal Reserve System is unable to avoid alternative risks associated with the higher growth rate of money supply, although it must take account of other forces in the economy so as to minimize these risks as much as possible. For this reason, the committee is prepared to regard some short-term increases in the growth rate of the money stock as reasonable, so long as they do not stimulate an immediate inflationary rise in bank credit.

The least satisfactory aspect of the problem was that neither the monetary authority itself nor the private witnesses were able to outline in any but the most general terms the manner in which the credit flow generated a flow of real output over time. Apparently the guidance offered by econometric models has not yet reached the stage of refinement that would yield a sufficiently accurate estimate. This is also the conclusion of the staff study of the Federal Reserve-MIT model, reported in the January 1968 Federal Reserve Bulletin.

Imperfections of knowledge not withstanding, the monetary policymakers have not given the committee or the public an adequate assurance that their time horizon is distant enough when they evaluate their alternatives. There was no hint that decisions were evaluated in the light of any agreed or stable priorities of aims. There was no description of the resolution of conflicts between competing aims, which must assuredly generate a high proportion of internal debate within the Open Market Committee. Above all, there was no allaying of the widespread doubt that the deliberations of the Open Market Committee were overly influenced by the most recent developments and the atmosphere generated by them, a process which, if it occurs frequently, could cause damaging variability of intentions and actions by the Federal Reserve Board. The suspicions have been increased rather than allayed by the ambiguous, nonquantitative, imprecise language of the directives to the Manager of the Open Market Committee which are now published with a 3-month delay in the Federal Reserve Bulletin.

The committee is aware of the high quality of the analysis performed within the offices of the Board of Governors, and of the advances in monetary analysis to which the Board has made a notable contribution. It would be gratifying to have some assurance that these new methods are being subjected to operational testing. In this way, the Federal Reserve System might best answer their critics whose testimony the Joint Economic Committee has heard with some sympathy, for it is certain that the current debate is not, to any extent, on the nature of the ends to be pursued, but almost entirely, on the methods and decisionmaking in their pursuit.

It behooves the Federal Reserve System, in brief, to show that it is taking adequate account of the income-generating potential over a long period that results from its making credit available, and is recognizing that an overfast increase has an inflationary potential.

IV

Even a discretionary monetary policy needs direction and evaluation

Since actions taken to affect the volume of bank reserves are necessarily and inherently quantitative in nature, it comes rather as a shock to note how imprecise the standards guiding monetary management are at all levels. The lack of guidelines is even more disconcerting since the built-in uncertainty precedent to action makes it impossible to assess or test after the event whether an action taken was of the character, scale, or timing that was intended or should have been expected in the public interest. Little wonder that without standards of direction or evaluation there is a generally uneasy feeling about, or a dissatisfaction with, the performance of monetary management.

It will be useful to divide the possible guidelines for monetary policy into three levels in what might be regarded as a descending order from objectives to policy to execution. First, there are guidelines relating to the ends or objectives to be promoted by the monetary authorities. Next are those relating to the specific monetary actions to be taken to promote these selected ends. And finally there are guidelines for carrying out the actions, that is, open-market purchases or sales, once policy has been determined. The central issue growing out of the present lack of guidelines is not the choice between a broadly discretionary system and a mechanistic system governing policy. It involves rather the level at which discretion is to be exercised—the Congress or its legally constituted agents, the Board of Governors and the Federal Open Market Committee, or an employee of the system commonly known as the manager of "the desk."

(1) Let us deal first with guidelines relating to the objectives of monetary policy. The Employment Act is quite specific in setting forth major objectives of economic policy: maximum employment, production, and purchasing power. As interpreted by numerous executive department statements and actions, in which the Congress has concurred, these are generally understood to involve maintenance of low rates of unemployment; reasonable stability in the purchasing power of the dollar; a high and stable rate of economic growth; and a stable exchange rate for the dollar. Likewise, the administration and the Congress have interpreted the Employment Act mandate as contemplating a harmonious integration of fiscal and monetary policies. Yet, neither the Federal Reserve System nor monetary policy are mentioned in the Employment Act.

These omissions are difficult to comprehend today, but more understandable when considered in the light of conditions that prevailed at the time of the Employment Act's passage. The country then was fearful that reconversion to a peacetime economy would be accompanied by mass unemployment. Preoccupied with the prospect of a recurrence of unemployment that characterized the thirties, when interest rates

were low, the Congress did not give much weight to monetary policies. Nevertheless, there is now general agreement that monetary policy is a basic instrument of public economic policy.

The Federal Reserve continually and explicitly recognizes the Employment Act objectives in its announced policies and, indeed, it has been zealous in exercising its own judgment in respect to the policy mix shown to achieve these objectives. It should be noted, too, that in addition to the aforementioned objectives of the Employment Act, there is often official pressure on the Federal Reserve to adapt its policy to other objectives or considerations—to avoid significant changes in money market conditions at times of new Treasury issues, to avoid "excessively high interest rates," to protect the flow of funds to nonbank financial intermediaries, and to ameliorate adverse effects on the residential construction industry.

Thus, the Federal Reserve suffers from no lack in the number of guidelines relating to its goals or objectives. However, it has been given virtually no official help as to how it should weigh the various objectives, assign priorities, or select among them when they come into conflict. Some of these objectives are likely to be at least partially incompatible, even under the most favorable circumstances. They will almost certainly be incompatible if monetary policy is not assisted by timely and appropriate flexible fiscal policies, or when overall fiscal policies throw an undue burden on monetary policy.

The Congress should give serious consideration to providing more specific guidelines relating to the objectives of monetary policy—guides relating to the weights and priorities to be attached to the various objectives. Such an attempt by Congress might yield two beneficial results. First, it might provide more specific guidance to the Federal Reserve in terms of goals or objectives. Second, the very process, including periodic reports by the Federal Reserve on its achievement of objectives, would afford Congress an opportunity to evaluate better the relative roles of monetary policies and of other policies, including various types of fiscal policies, in promoting and reconciling our economic objectives.

(2) We then come to the second level of shadowy standards upon which monetary action hinges—the intermediate targets of policy. These have been debated extensively in the professional journals, although without sufficient agreement having been reached to provide any automatic guide for monetary policy decisions.

Some economists tend to focus attention exclusively, or primarily, on changes in the rate of credit expansion, either in terms of total credit expansion or some critical segment thereof, such as bank credit. Others look principally to changes in the economy's liquid assets, either in the aggregate or in some segment of the total, such as the money stock. Others look principally to the terms and conditions on which funds can be borrowed, regarding changes in the level and structure of interest rates as the basis for establishing the course of monetary policy.

Stating the problem another way, what financial variable or variables should be used as intermediate targets of monetary policy? More specifically, in assessing whether monetary policy has been tight or easy, what interpretation should be assigned to the movements in the

stock of money, as against movements in other financial variables such as broader measures of liquid assets, credit flows and terms, money market conditions, or the level and structure of interest rates?

Section 12A of the Federal Reserve Act, as amended in 1933, reads simply:

> The time, character, and volume of all purchases and sales of paper described in Section 14 of the Act as eligible for open-market operations 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.

Clearly, the Congress, apart from specifying eligible paper, has not been explicit in providing guidance or setting standards for Federal Reserve authorities in the choice of instruments to be used in performance of the duties which have been delegated to them. Even when supplemented by the Declaration of Policy contained in the Employment Act of 1946, the statutory directives are broad and most general. This does not mean, however, that the agency charged by those statutes with day-to-day responsibility can do without some quantitative formulation of its objectives.

Unfortunately, the Federal Reserve itself does not appear to have developed a set of priorities for its own guidance. This lack of firm working criteria has troubled monetary students and members of this committee ever since the Board exposed its methods by making generally available the Record of Policy Actions of the Board of Governors and the Federal Open Market Committee. The minutes made available are couched in the most general, nonquantitative monetary and stabilization terms. They have tended to indicate a considerable reliance on intuition and mystique in shaping actions rather than giving Congress, or observers of monetary affairs, a full opportunity to follow the developing and sometimes conflicting concepts or reasons which have influenced decisions.

A single example will illustrate the lack of rules. One will suffice, although similar statements reporting procedures are made available with a 3-month lag in the monthly Federal Reserve Bulletin and may be read by all. The minutes of the July 18, 1967, Open Market Committee meeting report that:

> In the course of the Committee's discussion considerable concern was expressed about the recent high rates of growth of bank credit and the money supply, particularly in view of the prospects for more rapid economic expansion later in the year. It was generally agreed, however, that the Treasury's forthcoming financing militated against seeking a change in money market conditions at present. Moreover, even apart from the Treasury financing, most members felt that it would be premature to seek firmer money market conditions at a time when resumption of expansion in overall economic activity was in a fairly early stage; and some also referred in this connection to the growing expectations that the administration would press for measures of fiscal restraint. In addition, some members expressed concern about the possibility that any significant further increases in market interest rates might reduce the flows of funds into mortgages and slow the recovery under way in residential construction activity.

A member of the Joint Economic Committee is certainly not alone in asking, "Was the Fed continuing to create money at the rate of 9 percent [as it had been] because of Treasury borrowing, the level of production, expectations about future tax increases, worries about residential construction, or what? What weight was assigned to these factors? We are not told."

(3) Open Market Committee policy, thus arrived at without any apparent overriding rules or criteria, is summed up at each meeting in a broadly worded "policy directive," which, taken by itself, is admittedly not an adequate guide for day-to-day action. The full text of the several directives in effect during parts of the past year appear, as is usual, in the Board's annual report. Stripped of essentially repetitive and formal language, changes in the critical "policy" words during the year called upon the Account Manager to conduct operations with a view to:

Meeting	*Directive*
Dec. 13, 1966	Attaining somewhat easier conditions in the money market, unless bank credit appears to be resuming a rapid rate of expansion.
Jan. 10, 1967	Attaining somewhat easier conditions in the money market, unless bank credit appears to be expanding significantly faster than currently anticipated.
Feb. 7, 1967	Maintaining the prevailing conditions of ease in the money market, but operations shall be modified as necessary to moderate any apparently significant deviations of bank credit from current expectations.
Mar. 7, 1967	Attaining somewhat easier conditions in the money market, and to attaining still easier conditions if bank credit appears to be expanding significantly less than currently anticipated.
Apr. 4, 1967	[No change.]
May 2, 1967	Maintaining the prevailing conditions in the money market.
May 23, 1967	Maintaining the prevailing conditions in the money market, while utilizing operations in coupon issues in supplying part of the reserve needs.
June 20, 1967	Maintaining about the same conditions in the money market as have prevailed since the preceding meeting of the Committee, while continuing to utilize operations in coupon issues in supplying part of reserve needs.
July 18, 1967	Maintaining about the prevailing conditions in the money market; but operations shall be modified insofar as the Treasury financing permits to moderate any apparent tendency for bank credit and money to expand more than currently expected.
Aug. 15, 1967	Maintaining about the prevailing conditions in the money market; but operations shall be modified, insofar as Treasury financing permits, to moderate any apparent tendency for bank credit to expand more than currently expected.
Sept. 12, 1967	Maintaining about the prevailing conditions in the money market; but operations shall be modified as necessary to moderate any apparent tendency for bank credit to expand significantly more than currently expected.
Oct. 3, 1967	Maintaining about the prevailing conditions in the money market; but operations shall be modified, to the extent permitted by Treasury financing, to moderate any apparent tendency for bank credit to expand significantly more than currently expected.

Meeting	*Directive*
Oct. 24, 1967	[No change.]
Nov. 14, 1967	Maintaining about the prevailing conditions in the money market, but operations shall be modified as necessary to moderate any apparent tendency for bank credit to expand significantly more than currently expected.
Nov. 27, 1967	Facilitating orderly market adjustments to the increase in Federal Reserve discount rates; but operations may be modified as needed to moderate any unusual pressures stemming from international financial uncertainties.
Dec. 12, 1967	Moving slightly beyond the firmer conditions that have developed in money markets partly as a result of the increase in Federal Reserve discount rates; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations or any unusual liquidity pressures.
Jan. 9, 1968	Maintaining the somewhat firmer conditions that have developed in the money market in recent weeks, partly as a result of the increase in reserve requirements announced to become effective in mid-January; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations in bank credit from current expectations.

All that one can safely infer from such language changes in directives is that the Open Market Committee sought to have open market operations move in the direction of relative ease until the December meeting. Except for that shift in policy, the semantic changes in the various versions of the directive, standing by themselves, appear to have little operational meaning. Presumably they mean something, but the operational or quantitative significance is not clear. Outsiders, including the Congress, can judge neither the degree of change intended by revisions of the directives nor the extent to which the manager implemented the intended change in policy.

It may well be that members of the Open Market Committee talk in rather more quantitative terms and arrive at a consensus in more concrete terms, providing a more substantial guideline for operations in the interim between meetings. If there are indeed any quantitative guides or standards for action at this level—the operational level—it is not clear why the outside reader, seeking to understand the niceties of policy, must always be sent back to reread and compare the old and new fine print in order to understand what has been going on in monetary administration.

The vagueness and obscurity of the reports on policy actions (and, at the succeeding level, the resultant directives to the "desk") arise, one may be sure, not so much from willful veiling in reporting marching orders as from an inherent imprecision in the objectives, policy standards, and operations themselves.

One might have hoped, of course, that, under the admittedly broad delegation from the Congress, the monetary authorities themselves would have tested and developed working criteria or quantitative rules of thumb by which to guide and later test policy decisions and results.

While some recent progress has apparently been made in developing economic and computer models, the uneasiness and dissatisfaction with the results of past policy actions have prompted many people to wonder whether monetary management must forever remain an "art" dependent upon the "color, tone, and feel" of the money and credit situation. Is it necessary, as was suggested at the hearings, that the monetary authorities must forever "fly by the seat of the pants"? The Joint Economic Committee has consistently thought not. To this end, it has sought ways of improving the situation. The evolution of its search for some rules or standards is discussed in the following section.

V

A set of projections and rules for monetary action, with opportunity to explain deviations, would be better than no guidelines at all

The Joint Economic Committee has on occasion made some rather specific recommendations for the conduct of monetary policy. These have been put forward with the intention of pointing directions in which Congress and the monetary authorities hopefully can improve the actions and policy of monetary management, through more explicitly stated objectives and guidelines. An awareness that almost any rule of guidance will have some drawbacks as well as advantages has been an important consideration in prompting this particular set of hearings.

The testimony and advice of the experts, together with the resultant exchange of ideas, lead us to what we believe is an improved restatement or refinement of our earlier proposals. These modifications are set forth more fully later in this report; but since the earlier statements have been so largely the focus of this study, it seems appropriate to repeat them here in this report as the best way of bringing out the types of problems involved and the kinds of revised rules which we hope will advance the discussion and sharpen the use of the monetary instruments.

In our report of March 1967, we said:

> The committee urges that the monetary authorities adopt the policy of moderate and relatively steady increases in the money supply, avoiding the disruptive effects of wide swings in the rate of increase or decrease.
>
> The committee is impressed with the increasing weight that many economists give to the importance of a steady rise in the money supply. Such rate of increase should be more or less consistent with the projected rate of growth—generally within a range of 3 to 5 percent per year. Sudden changes in the money supply give rise to instabilities in the economy. We are convinced that restoration of economic growth and avoidance of a recession demand such increases in the money supply as recommended above. [p. 14.]

The Joint Economic Committee, in its recent annual Economic Report of March 1968, again reiterated this recommendation of earlier years. The words in the current report are these:

> We are thus convinced that a steady rise in the money supply more or less consistent with the projected rate of economic growth—generally within a range of 3 to 5 percent per year—would be a healthy, long-run ideal. But the very essence of such a policy is to avoid large and sudden changes or reversals.

The paragraph just preceding reads:

> * * * the Joint Economic Committee has consistently * * * [urged] that the preferred course would be to follow a pattern of steadily creating money in keeping with the growth in the economy, aiming perhaps at the higher side of some range at times of slow economic growth, and in years of inflationary pressures leaning toward the lower end of the register * * *

The guidelines that can be devised for monetary action ought not to be interpreted as rigid directives. The evidence presented before the committee, by witnesses of different viewpoints, gave examples of exceptions to strict rules that were by no means rare contingencies. There has to be room for deviation from rules, and for the exercise of discretion in response to need.

On the other hand, a prolonged departure from what could be called a reasonable long-term range of variation of such an indicator as seasonally adjusted money stock, or credit proxy for money stock, does not appear to be justified. Even if neither the Fed, proclaiming its entitlement to be unrestricted by rules, nor its critics, asserting the need for such rules, has precisely traced the effect of, say, a zero or negative growth rate of money or a prolonged growth rate in excess of an annual rate of 6 percent, it is still reasonable to believe that such abnormal policies would generate instability.

One question faced by the committee was to designate an approximate time span for the measurement of changes in the money stock. The time basis used by Governor Mitchell in his testimony appears to be entirely adequate—the comparison of change from one quarter to another. A 3-month period is sufficiently long to allow abnormal and extreme temporary movements to be absorbed in an average, and it is short enough to provide a reasonably frequent measure of the course of events. Of course, seasonal adjustment will eliminate regularly recurrent variations in the course of any year.

The committee estimated that, on a quarter-by-quarter comparison, an appropriate normal range of increase in the money stock seasonally adjusted would be 2 to 6 percent per annum and that, on occasions when the rate of increase was outside this range, it would be wise for the Congress to take a prompt look at the Federal Reserve System's actions. Moreover, the Congress should have the benefit of periodic reports to review actions taken within the above range.

There is no intention to make the 2 to 6 percent range a permanent and unchanging one. Advances in banking techniques, economization in the use of those forms of credit within the definition of money, changes in business practices, in the rates of growth of population or productivity, or even in personal preferences—all can modify the desirable range of money growth rates. In the meantime, however, the pragmatic choice of 2 to 6 percent requires the Federal Reserve System to explain only significant abnormalities in monetary developments.

Furthermore, the Federal Reserve should give valuable guidance to the Congress in a reciprocal fashion, by making known its own estimates of quantitative developments in the national accounts, estimates that are prepared early in each calendar year and on which the

broad lines of monetary policy would be based. Unlike the periodic directive to the Manager of the Open Market Account, these projections are not required to be secret at all. While it is likely that the projections are similar to those used by the Council of Economic Advisers for the President's Annual Economic Report, there is some need for greater detail in the Federal Reserve System's expectations on monetary developments. These figures would, moreover, be useful in assisting Congress to pursue fiscal policies that would be compatible with the Federal Reserve's monetary policy.

Until about ten years ago, U.S. economic policies, and monetary policy in particular, enjoyed an unprecedented exemption from the need to take account of external reactions. Now, the U.S. balance of payments exerts a strategically important, if quantitatively small, influence on our fiscal and monetary posture. Relatively free movements of short-term funds between the United States and the increasingly developed Eurodollar market have the incidental effect of lessening the precision of Federal Reserve policy, in regard to money supply and in other ways. It is not the purpose of this report to go into detail on these problems, still less to advocate deflationary action in order to moderate the U.S. overall international deficit. But it is appropriate that the report recognize that at this time there is no conflict of prescriptions for attaining domestic and international objectives. At some other time, however, there may be conflict between domestic and international monetary prescriptions, in which case it will be necessary to decide on priorities, as well as to enlist the aid of fiscal policies.

FINDINGS AND RECOMMENDATIONS

I

The Congress should give serious consideration to providing more specific guidelines relating to the objectives of monetary policy—guidelines relating to the weights to be attached to the various objectives, among which are maintenance of continuously low rates of unemployment, reasonable stability in the purchasing power of the dollar, a high and stable rate of economic growth, and a stable exchange rate for the dollar. Such an attempt by Congress might yield two beneficial results: First, it might provide more specific guidance to the Federal Reserve in terms of goals or objectives. Second, the very process would afford Congress an opportunity to evaluate better the relative roles of monetary policies and of other policies, including various types of fiscal policies, in promoting and reconciling our economic objectives. However, as noted earlier in the report, these guidelines ought not to be interpreted as rigid directives.

II

Just as the Congress has the authority to fix Government expenditures and taxes, and thus largely to determine the budget surplus or deficit, the Congress has the responsibility of reckoning with the monetary consequences of its action. While the monetary authority granted to the Congress by the Constitution has been delegated to the Federal Reserve System, it behooves the Congress to provide some guidance to the Federal Reserve on how the System should see to the support of the Government's credit and, in particular, to what extent Congress regards the expansion of Federal Reserve credit as an appropriate way to finance any part of the deficit.

III

To provide a first approximation to an economic posture that would manage to maintain price stability while encouraging maximum employment and rapid economic growth, the Congress should advise the Federal Reserve System that variations in the rate of increase of the money stock (currency plus demand deposits adjusted) ought not to be too great or too sharp. In normal times, for the present, the desirable range of variation appears to be within the limits of 2 to 6 percent per annum, measured on a quarter-by-quarter basis—a range that centers on the rate of long-run increase in the potential gross national product in constant dollars, which is our sustainable real growth rate.

On any occasion on which the Federal Reserve System, deliberately or as a result of external monetary developments, has not maintained a money-stock growth rate within the desired range, the committee requests that the monetary authority report promptly to it, or to another appropriate body of the Congress, on the reasons that the Fed-

eral Reserve System would give for this divergence. Periodic reports on the reasons for action taken within the desired range should also be made.

If, after several years' experience with a rule, refinements in the guidelines seem warranted, they could, and should, of course, be made.

IV

Finally, as a regular procedure, the Federal Reserve authorities should, at the beginning of each year, set forth publicly as specifically as possible their notion of what kind of monetary policy the expected state of the economy calls for. This would supplement in the monetary field the review of the Federal Government's economic programs which the President is now required to set forth in the Economic Report. Such a public projection (which we understand is already available internally) would present a picture of what the financial world—money supply, flows through financial intermediaries, the appropriate course of interest rates—would look like. This would also tie in with the gross national product projection indicated in the report of the Council of Economic Advisers. It would certainly help Congress to adopt the necessary fiscal policies and to foresee and forestall potential problems such as those resulting from disintermediation, oppressive interest rates in the housing field, international capital flows, and the like.

SUPPLEMENTARY VIEWS OF REPRESENTATIVE PATMAN

While I agree with many of the conclusions reached by my colleagues concerning the policies that have been pursued by the Federal Reserve System, I do not think that the remedies proposed go far enough.

I have long believed that a monetary policy directed toward the goals of the Employment Act will not be achieved within the present institutional structure. As long as we allow the Federal Reserve System to act independently, even in defiance, of the Government, and as long as we allow control of our monetary powers to rest in the hands of a self-appointed money trust, we cannot hope to reverse the direction of our current monetary policy.

My views on the so-called "independence" of the Federal Reserve are set forth in detail in the Report of the Joint Economic Committee on the January 1965 Economic Report of the President, and I will not repeat them in detail here. Briefly, the main points raised in that statement were the following:

1. Despite the original intent of the Congress, the Federal Reserve System over the years has become increasingly banker-oriented.
2. Polls and studies have shown heavy preponderance of banking background among the directors of the 12 Federal Reserve banks who, in turn, select the bank presidents.
3. These developments have led to a lessening of public control, as represented by the Federal Reserve Board, and toward increased domination by the banking interests.
4. This unfortunate situation is especially apparent in the representation on the Federal Open Market Committee, which, through the purchase and sale of Government securities, exercises the fundamental monetary powers of the Nation. Although the Committee is made up, on the record, of five Reserve bank presidents and the seven members of the Board, all 12 bank presidents participate in the secret deliberations of the Committee.
5. Public control of the Federal Reserve Board itself is diluted by the length and distribution of members' terms. The members serve for 14-year terms, staggered at 2-year intervals. Consequently, a President serving for two full terms could not appoint a majority of the Board until the end of his second term. He is also restricted in his choice of Chairman to the present membership of the board.

The fact that the existing situation is intolerable and dangerous is underscored by two issues raised in the Committee Report. The first is the need for coordination of all of the Government's economic instruments and policies. Coordination of our economic policies is the first priority toward achievement of the goals set forth in the Employment Act. But the independent and sometimes actually defiant attitude of the Federal Reserve makes coordination of the Government's eco-

nomic policies difficult, if not impossible. A dramatic example of this predicament occurred in December 1965, when the Federal Reserve ignored the pleas of the President and raised interest rates without waiting just a few weeks until the Government's budget and fiscal plans could be completed. In effect, the Federal Reserve openly defied the President, the Secretary of the Treasury, the Budget Director, and the Council of Economic Advisers, and forced the President to adopt budgetary and fiscal policies in light of the Federal Reserve's action. I think it is intolerable to allow the Federal Reserve to dictate economic policy decisions to the President.

The other point I would like to emphasize is the Federal Reserve's interest rate policies. As the Report states, our interest rates are now at their highest level for a century. Rates have been rising consistently since World War II, and are now at a dangerous level.

I think there can be little doubt that we can thank the bankers who control the Federal Reserve for this situation. Interest rates are the bankers' income, and, of course, the higher the rates, the greater bank profits.

I think it is clear that we have reached a point where banker domination of our monetary system has imperiled the welfare of our citizens. In my view, the most important economic and governmental problem facing the Nation today is the need for immediate rehabilitation of the Federal Reserve System, so that it is again subject to the will of the people, acting through their elected representatives. The Constitution clearly vests the monetary power in the Congress. It is high time that the Congress reassert its proper control.

Another aspect of the Federal Reserve that is absolutely wrong is the $50 billion portfolio of bonds kept in the Federal Reserve bank vaults. The Federal Reserve is collecting $2 billion of interest each year as if it were a private citizen investing in U.S. bonds. Yet the fact is that these bonds have already been paid for by the U.S. Government, an event that occurs when the Federal Reserve, acting as the Government's agent, *repurchases* these bonds. It is absolutely absurd to permit the Fed, as the Government's agent, to collect this massive amount of interest; moreover, it permits the Fed to operate completely free of the whole appropriation process. They spend as much as they want of this huge flow of interest without any outside controls whatsoever. As I have often observed, this situation can be compared to that of a private individual who pays off his mortgage but then has to continue to pay interest to the mortgage company that acts as his agent. This would be absurd and illegal in the case of a private individual, but we permit the Federal Reserve to get away with it.

The Joint Economic Committee made an extensive study of this situation, under my direction, 2 years ago. We solicited the views of a large number of economists and monetary experts and a great many of them suggested that this practice be stopped because there is no need for it and no point to it. I urge Members of Congress to consider this situation and correct it.

O