

FEDERAL RESERVE BANK OF NEW YORK

Sent to all members of Federal Open Market Committee and to Presidents not on Committee.

CONFIDENTIAL

July 16, 1953

Mr. O. S. Powell, Member,
Federal Open Market Committee,
c/o Federal Reserve Bank of Minneapolis,
Minneapolis 2, Minnesota.

*in General
Folder*

Dear Mr. Powell:

In order to clear my desk before going on vacation, I have found it necessary to complete a memorandum on some of the matters which were discussed, but not decided (except on a temporary basis), at the meeting of the Federal Open Market Committee last March, when the report of the Ad Hoc Subcommittee on the Government Securities Market was debated. A copy of this memorandum ("Open Questions from the Report of the Ad Hoc Subcommittee to the Federal Open Market Committee") is enclosed. It has been prepared with the help of some of my associates, and its appendices "A", "B" and "C" were prepared by individuals who also contributed to the general memorandum.

There is also enclosed the reference from the minutes of the March meeting to the question of the organization of the Federal Open Market Committee, and a copy of my discussion of this subject which I sent to you under confidential cover in a memorandum dated February 18, 1953. Certain additional aspects of this latter matter have presented themselves, or have been emphasized, in the intervening months and they might be worth thinking about.

One of the factors which may concern those who find "anomalies" in the present structure and organization of the Federal Open Market Committee is the continuance of attacks by certain highly vocal members of, or groups in, the Congress upon the lack of control of the Congress over the operations of the Federal Reserve System (expenditures, budget, accounting, etc.) and the lack of complete control of the Board of Governors over open market operations and those who execute open market policy. It is suggested that the System can't survive free of detailed and debilitating "Government interference," if the present operating structure of the Federal Open Market Committee is continued. I would hold a contrary view. I do not think the System can survive as a regional system, with an appropriate decentralization of power and authority and appropriate freedom from Government civil service, budgetary and accounting controls, if we try to appease these Congressional critics whenever they attack us. They are working toward what they would call the nationalization of the Federal Reserve System, which I assume would mean a wholly owned Government system, set up much as are other departments of the Government with a "head office" at Washington and "branches" out in the country. If, contrary to our judgment on the merits, we attempt to appease them, in this case by a change in the organization of the Open Market Committee, we shall be taking the System

one step nearer to the goal they have in mind, and we shall have made it that much easier for them to press the final step which eventually wouldn't have to be much of a step.

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Rather than appease such critics I think we should hold fast to what we think is right and proper in our present organization -- and in our policies and operations -- and rely on the ordinarily quiet majority in the Congress to support us if the matter comes to an issue. When we have really wanted to make a fight for a position or a principle, we have usually found that we had more defenders in Congress (and in the country) than the day-to-day flow of Congressional talk and the statements of individual members of Congressional committees might suggest. If the fear of Congressional attack on the System is a cause for concern about the organization of the Federal Open Market Committee, I think it would be a great mistake to play into the hands of our critics by coming forward with proposals (presumably requiring legislation) designed to provide the Committee with "funds and a staff of its own." It already has, in effect, funds and a staff of its own provided nationally within the framework of a regional Federal Reserve System, and sanctioned by nearly twenty years of operation under the law adopted by the Congress in 1935. If there is widespread dissatisfaction within the Congress concerning the present organization of the Federal Open Market Committee it hasn't shown itself publicly. If there is dissatisfaction within the System, as to the way in which open market operations have been carried out, that is another matter which should be considered within the System and not made the basis of setting up a wholly new organization, unless it is clear that it has been the form of organization, rather than the Committee or individuals serving the Committee, which has been at fault.

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This leads me to a second observation. It has been suggested that under the present arrangement:

- (a) Members of the Federal Open Market Committee are reluctant to criticize operations which involve a colleague (that is, the President of the Federal Reserve Bank of New York).
- (b) Members of the Federal Open Market Committee, and Presidents not serving as members of the Committee, are reluctant to call upon the Manager of the System Open Market Account for explanations and information or to make suggestions about open market operations.
- (c) The other Federal Reserve Banks are reluctant to ask that members of their staffs be given an opportunity to sit in on the operations of the Open Market Account as part of their training and development for a System career.

The implication is that all this would be changed if the Open Market Committee had a staff of its own (and particularly if the Manager of the Account were made directly responsible to the Federal Open Market Committee as a whole), which each member of the Committee could consider as part of his staff. (Query: would this improve the position of Presidents who are not members of the Committee?)

As to (a) I should say that no matter how it is set up, the Manager of the System Open Market Account should have continuing contact with the Committee (and especially its Executive Committee) through some member of the Committee. As now organized, of course, the Manager of the System Open Market Account is in constant touch with the Vice Chairman of these Committees (and less frequently with the Chairman). Presumably if the Manager were employed directly by the Committee, instead of through the Federal Reserve Bank of New York, he would still have to be located in New York, unless it is contemplated that operations could be conducted from Washington. In any case, he would have to maintain continuous contact with either the Chairman or Vice Chairman of the Committees. There would, therefore, be no change in the problem of reluctance to criticize a colleague; in fact it might be intensified if the Chairman was the colleague. In my opinion, of course, this criticism of present arrangements is at least exaggerated.

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With respect to (b) some members of the Federal Open Market Committee apparently have always felt free to call the Manager of the System Open Market Account and talk with him or question him about open market operations. This is as it should be. The fact that the Manager of the Account is also an officer of the Federal Reserve Bank of New York does not change his status as a servant of the Committee. If other members of the Committee have been reluctant to follow this practice, I would suggest that it would be better to overcome the reluctance than to create a wholly new organization in order to try to avoid it.

Similarly with respect to (c). We have always held ourselves open to receive anyone the other Federal Reserve Banks (or the Board) wished to send to us to observe and study the actual practices of open market operations (subject only to the reservation that we have tried to arrange the timing of such visits so that the members of our Securities Department could give the visitors the time and attention required to make their visits worthwhile). We consider that this function of the Federal Reserve Bank of New York has a role to play in contributing to executive training and development programs, in the case of "coming" men in the System, and that our Securities Department is a place where those who have already arrived (including Presidents) can brush up on their knowledge of current operations, if they so desire. It may be that there is some reluctance to "impose" in this way on the Federal Reserve Bank of New York. The direct answer is that we do not consider it an imposition, and we do not know what sort of an alternative set-up is practical which would not pose approximately the same problem.

There have also been suggestions that it might be desirable to have men from other banks (or the Board) work in our Securities function (open market operations) for short periods (three months say) as distinguished from those who come for a shorter time to study or observe. We have held ourselves ready to accommodate such persons, within the limits of such a program, by an arrangement which would place them on our staff and payroll for the period they spend with us. This latter qualification is merely considered good organizational and administrative procedure, if men are to have actual responsibility for work in the department. There is nothing difficult or intricate about such arrangements. It was tried out last year in what was expected to

be the beginning of such a program, but the man who came to us was pulled off the job, before he had finished his tour of duty, to work with the Ad Hoc Subcommittee, and thereafter the idea seemed to die. If there is really continuing interest in it, I am sure it can be made to work.

I thought you would want to have this expression of views as an aid to our further consideration of important questions in which we all have a sincere interest.

Yours faithfully,

ALLAN SPROUL

Allan Sproul, Vice Chairman,
Federal Open Market Committee.

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Enclosures

Extract from personal and confidential memorandum, dated February 18, 1953, from Mr. Sproul, Vice Chairman, Federal Open Market Committee, and President, Federal Reserve Bank of New York, to all members of Federal Open Market Committee and Presidents of Federal Reserve Banks, on the Report of the Ad Hoc Subcommittee on the Government Securities Market.

"ORGANIZATION OF FEDERAL OPEN MARKET COMMITTEE

"Under the somewhat disarming heading of 'Housekeeping' the ad hoc committee discusses the organization of the Federal Open Market Committee. It says that it finds many anomalies in the structure and organization of the Open Market Committee and recommends that the Committee reexamine and review its present organization and, in particular, that it consider the advantages and disadvantages that would ensue were the Manager of the System Open Market Account made directly responsible to the Federal Open Market Committee as a whole and not, as at present, responsible to the Federal Reserve Bank of New York. This seems to me to be more than a matter of 'housekeeping'; it involves the structure of the house.

"I do not think the present organization of the Federal Open Market Committee is an anomaly. What we are dealing with is a unique body for which there is no common rule. Considering the evolution of the present Federal Open Market Committee, the Congressional act which created it, and the intent of that act, I know of no evidence that the Open Market Committee was to be other than a policy-making body directing the open market operations of the Federal Reserve Banks. There is no sign that it was also expected to become an operating body executing policy through a separate staff of its own, or even through a separate executive officer without a staff, if such a thing be possible. The procedural rules and organizational structure adopted by the Federal Open Market Committee, and tested and accepted publicly and privately over the past seventeen years, seem to me to have carried out the mandate of the Congress, to have met the requirements of Committee responsibility, and on the whole to have done a creditable job. If new and different forms, probably involving unforeseen 'bugs' and defects, are to be adopted, a much stronger case for them and condemning the present forms, would seem to be required.

"The real crux of the problem, which evidently bothered the ad hoc committee, is how to make an effective transit from policy to execution of policy, across an intervening area of mixed policy and execution. The by-laws of the Federal Open Market Committee provide for a Chairman and Vice Chairman, the Chairman to preside at meetings of the Committee and to 'perform such other duties as the Committee may require' him to perform; the Vice Chairman to 'perform the duties of the Chairman in the absence of the Chairman.' These two 'officers' of the Committee, in the past, were

designated by the Committee, and its Executive Committee, to represent them in discussions with the Secretary of the Treasury concerning open market (or credit) policy and debt management. In addition to their formal duties, and their responsibilities for liaison with the Secretary of the Treasury, the Chairman and Vice Chairman have ordinarily conferred between meetings of the Executive Committee of the Federal Open Market Committee, whenever it was deemed necessary in connection with the execution of open market policy. In a sense they thus became an executive committee of the Executive Committee (which by its nature cannot meet from day to day or hour to hour and master-mind open market operations), and a bridge between the policy-making body and its executive officer, the Manager of the System Open Market Account.

"The by-laws of the Federal Open Market Committee, as you know, provide for the selection by the Committee of a Federal Reserve Bank to execute transactions for System Open Market Account, the Committee itself not having the legal authority (nor the funds) to buy (or sell) securities. The Federal Reserve Bank of New York as the Federal Reserve Bank in the principal money market and the central market for Government securities of the country has regularly been selected by the Federal Open Market Committee to execute transactions for System Open Market Account.

"The Manager of the System Open Market Account is selected in accordance with the by-laws of the Federal Open Market Committee, which provide that the Federal Reserve Bank selected to execute transactions for System Open Market Account, shall select a Manager of the System Open Market Account 'who shall be satisfactory to the Committee'. The Manager of the System Open Market Account has always been the Vice President of the Federal Reserve Bank of New York in charge of its Securities function. In acting for the Federal Open Market Committee, as Manager of the System Open Market Account, he is considered to be performing a function assigned to him, by the Bank as one of its duties and responsibilities growing out of its selection as the Bank which is to execute transactions for the System Open Market Account. In performing this function, which involves the execution of the open market policies determined by the Federal Open Market Committee (and its Executive Committee), the Manager of the Account is controlled by the policy directions of the Committee, of which he is directly informed by attendance at meetings of the Committee. These directions cannot be changed or altered by the Bank, or by anyone except the Committee itself.

"It is difficult to see how much further you can go in bridging the area between policy and execution, without messing up both. It is part of our creed that we are a regional system united for national purposes. The Federal Open Market Committee is a unique embodiment of that creed. It is the one place in the System where the Board of Governors and the representatives of the Federal Reserve Banks sit down around a common council table

as individual members of a statutory body with equal individual powers and responsibilities. Yet this Committee which has the final power with respect to all open market operations of the Federal Reserve Banks is itself constituted by statute of members having other major responsibilities rather than of members having no other functions. This was inevitable. Open market operations cannot be considered, directed and operated separately and apart from other aspects and weapons of credit policy. There is no question of anyone wearing 'two hats'; we all wear one hat, the hat of the Federal Reserve System. I must confess difficulty, therefore, in seeing what logic of chart-making or what consideration of the responsibilities of individual members of the Federal Open Market Committee, or what unspecified dangers, now suggest or require that the Manager of the System Open Market Account be set apart with a separate hat.

"The fact is that the Manager of the System Open Market Account and his principal assistants devote their attention and give their time almost wholly to the work of the System Open Market Account. Their other work does not conflict with this primary job; it contributes to the effective performance of their main duties in behalf of the Federal Open Market Committee. I say that the other duties of the Manager of the System Open Market Account (and of his assistants) contribute to the effective performance of his primary job, because I believe that the attention given by the Manager of the Account to fiscal agency or foreign correspondent relationships of the Federal Reserve Bank of New York serve generally to broaden his knowledge and increase his capacity for the performance of his primary duties. As the report of the ad hoc committee points out, the Government security transactions of the Federal Reserve Bank of New York, other than for the System Open Market Account, are quite substantial and they can exert a significant short run influence on the money market. If there be concern about market confusion as to the source of these operations their complete separation in terms of contact with the market could be arranged. To separate them from the Manager of the System Open Market Account would be to carry purism unnecessarily to the point of interfering with effective operations.

"Speaking even more personally, I find the concern of the ad hoc committee about the role occupied by the President of the Federal Reserve Bank of New York a little disturbing. The ad hoc committee does not suggest, and I assume it did not intend to suggest, that the President of the Federal Reserve Bank of New York would condone or defend day-to-day operation by the Manager of the System Open Market Account at variance with the proper execution of the policies of the Federal Open Market Committee. But the ad hoc committee does say that he comes to the meetings of the Federal Open Market Committee, and its Executive Committee, as a protagonist for the actual day-to-day operations of the Account and that the Committee, therefore, in some part loses contact with the critical insight of its best informed member. In my opinion, the Federal Open Market Committee gets a greater return from having one of its members in close touch with and giving some supervision to the day-to-day operations of the System Open Market Account, than it would get from having this member criticize these operations after the fact, even if it be granted (which I do not) that his present role debars him from constructive

suggestions about changes in operating technique. Nor does it seem to me a weighty argument that members of the Federal Open Market Committee, including as it does, all of the members of the Board of Governors as well as five of the Presidents, would be reluctant to seem critical of a colleague. Over the years, as I have observed it, such reluctance has usually been overcome if there was anything important in the balance. And it must be remembered also, that there are on the staff of the Federal Open Market Committee, drawn from the staff of the Board of Governors and from the Research directors at the Federal Reserve Banks, able people ready (some of them eager) to question the management of the Account, in advancing their theories as to how it should be managed. They are usually heard by the Committee or some of its members.

"Finally, I do not believe that the present position of the President of the Federal Reserve Bank of New York makes fuzzy the line of responsibility between the Federal Open Market Committee and the Manager of the System Open Market Account. That line is 'direct and undivided', in the real sense of the words; the difficulty is the dividing line between policy and operations. From that standpoint, whether the Manager of the Account consults with the President of the Federal Reserve Bank of New York from a secluded nook, as an employee of the Federal Open Market Committee, or whether he does it as at present, the President of the Federal Reserve Bank of New York would be concerning himself with operational as well as policy matters.

"The ad hoc committee seems to be seeking some way to bring the other individual members of the Federal Open Market Committee into the field of open market operations. The question of enabling other members of the Committee to increase their knowledge of open market operations, and thus to improve their participation in the formulation of open market policy, is not, in my opinion, a question of organizational shifts or operational arrangements. The first requirement is an absorbing interest in and constant application to the problems of credit policy in general and open market operations in particular. The second requirement is to use the means presently available to become more familiar with the techniques of open market operations. Difficulties of time and space will not be overcome by making the Manager of the System Open Market Account a direct employee of the Federal Open Market Committee rather than an employee of the Federal Reserve Bank of New York, approved for this job by the Committee. The suggestion that individual members of the Federal Open Market Committee might feel less reluctant (than they now are) to make direct contact with the Manager of the System Open Market Account, if he were an employee of the Committee, implies a reluctance I did not know existed. There should be no such reluctance, of course. It should be clear to every member of the Federal Open Market Committee that the Manager of the System Open Market Account is answerable to him for information on the techniques and details of open market operations. It should also be clear, however, that the Manager of the System Open Market Account cannot be expected to take instructions as to operations in general, nor as to specific transactions from several different members of the Committee, or from members of the Committee staff.

"This question of where policy-making ends and operations begin exists in all organizations except one-man dictatorships. There is a twilight zone. The Open Market Committee, in addition to fixing policy, has a proper concern with the general operational methods adopted to carry out policy. But a Committee cannot run the Account from day to day and, in my opinion, it should not try to place too many limitations on the executive discretion of the Manager of the Account who must make prompt decisions in changing circumstances. It would be a mistake, I think, for the Federal Open Market Committee to try to give the Manager of the Account, whether appointed as at present or made a direct employee of the Committee, too detailed instructions as to how to carry out the policies of the Committee.

"The new organizational arrangement suggested for consideration by the ad hoc committee would not create a distinct separation between policy and operations. The Federal Open Market Committee would only be transferring to its executive, through different channels, those aspects of policy-making which are involved in operating decisions. Giving credit for good faith, the institution and the men involved in the present arrangements for executing open market policy, are directly and wholly responsive to the directions of the Federal Open Market Committee. They do not try to bend policy by operating decisions."

"Chairman Martin next referred to recommendation E, Organization of the Open Market Committee, appearing on pages 85-86 of the subcommittee's report. This recommendation related to the "house-keeping" functions of the Committee and read as follows:

E. Organization of the Open Market Committee

The Subcommittee finds many anomalies in the structure and organization of the Federal Open Market Committee, particularly (a) the absence of a separate budget covering its operations, (b) the absence of a separate staff responsible only to the Committee, and (c) the delegation of the management function to an individual Federal Reserve Bank. It recommends that the Committee re-examine and review its present organization, and in particular that it consider the advantages and disadvantages that would ensue, were the Manager of the Open Market Account made directly responsible to the Federal Open Market Committee as a whole, and not, as at present, responsible through the Federal Reserve Bank of New York.

"Chairman Martin said that, as the recommendation indicated, this problem had given the ad hoc subcommittee considerable difficulty; the subcommittee did not profess to have the answer and its report presented the question as a continuing problem which should be considered further. He suggested that this recommendation be eliminated from the discussion at this meeting and that the ad hoc subcommittee be continued and instructed to meet with Mr. Sproul at an appropriate and convenient time for the purpose of discussing with him the housekeeping arrangements covered in the report, with a view to determining whether it would be worth while to make further exploration of the subject.

"Mr. Sproul stated that this procedure would be agreeable to him.

"Thereupon, Chairman Martin's suggestion was approved unanimously."