October 25, 1955

Memorandum:

To Members of Special Subcommittee of the Federal Open Market Committee

Subject: Management of the System Open Market Account

From J. L. Robertson

The past year has seen the introduction of proposed legislation to abolish the Open Market Committee and to transfer its functions to the Board of Governors, and the Board has received a publicized recommendation that the "executive offices" of the Open Market Committee be transferred from New York to Washington.

I believe that the membership on the Open Market Committee of five Federal Reserve Bank Presidents adds materially to the strength of the Committee and the soundness of its judgments and operations. The question of physical location of the Account Manager is a more doubtful one, but I am satisfied that, for the present at least, the disadvantages of removing the Manager from New York to Washington would outweigh the possible benefits.

Nevertheless, there is some validity in one idea that underlies the proposals referred to - namely, that it would be desirable for the Account Manager to be more directly and exclusively responsible to the Open Market Committee than presently is the case. The job of this Subcommittee is to devise a procedure that will make System Account transactions reflect the Committee's policies as accurately as possible, while preserving the advantages of having the Manager located in New York, the nation's financial center.

To this end I suggest the advisability of proceeding in accordance with Chairman Martin's memorandum of May 10, 1955 on the "Status of the Manager of the System Open Market Account". Briefly summarized, the Chairman's proposal was that the Committee should select the Manager and fix his salary, and that the Manager should devote himself entirely to the work of the Committee and should be responsible solely to the Committee. The Manager and his staff would be on the pay roll of the New York Federal Reserve Bank, but apart from such "personnel" arrangements for convenience, the Manager and his staff actually would be employees of the Committee. The physical situs of our Open Market operations would remain in New York, but the step from policy to operations would be directly from the Committee to the Manager, rather than through the intermediacy of the New York Bank, as at present.

At worst, direct responsibility of the Manager to the Committee (rather than responsibility through an intermediary, the New York Bank) could hardly diminish the responsiveness of the Manager to the Committee's wishes; at best, the responsiveness of the Manager would be enhanced by the removal of an unnecessary link in the chain between policy formation and operations. In other words, it may be that there is nothing to be lost and something substantial to be gained by a more direct relationship between the Manager and the Committee. An additional benefit of the Manager's not being a part of the operating structure of the New York Federal Reserve Bank would be that the Manager would no longer be responsible to, and report to the directors of that Bank, and the possibility of "leaks" in that area would be avoided. This is not to imply that such leaks have occurred, but merely that it is advisable to avoid any chance of such occurrences if that can be achieved without loss of other advantages.

Of course, the Manager should have access to all pertinent information and material in the System and the benefit of any studies which relate to Open Market work. It is probable that the Manager and his staff should undertake the task of training others throughout the System in Open Market techniques so that there would always be a supply of persons available to fill vacancies in the staff at all levels.

The foregoing arrangement would represent a long step in the right direction, but in my opinion it does not provide a complete answer to the question of how we can establish a more appropriate relationship between the Open Market Committee and the execution of its policies. Therefore, I submit for consideration a refinement along the lines of the suggestion contained in my memorandum to the Special Committee on July 6, 1955. This refinement involves an expansion of the duties of the Committee's Secretary. As I stated in that memorandum, by virtue of his location in Washington and the ready availability of daily contact with a majority of the members of the Committee, the Secretary is permeated to an exceptional degree with the "feel" of Committee policies, just as the Manager develops the feel of the money market through his daily contacts in Wall Street. In the event of need, the Secretary can quickly and conveniently check his understanding of Committee policies with a majority of the Committee members themselves. Finally, by virtue of his separation from the mechanics of the money market, the Secretary is in a position to fix his mind almost exclusively on the major objectives of the Committee's current monetary policies, to a degree that would seem to be psychologically impossible for the Manager, who is necessarily preoccupied, to a considerable extent, with the practical effectuation of policies.

Accordingly, I suggest an arrangement under which the Manager of the Account and the Committee's Secretary would be jointly responsible with respect to proposed market actions (or inactions). Under this arrangement, two men would determine whether proposed transactions or inactions were in accord with current Committee policy.

If this proposal is agreed to in principle, the modus operandi will develop as different types of situations are encountered. The essence of the proposal is that the Manager is to look to the Secretary for a check on his understanding of current Committee policy and whether proposed transactions would conform to that policy.

In all probability, the Secretary ordinarily would agree that the Manager's program of market transactions (or inactions) for the day is in accordance with the Committee's current objectives. In relatively few instances, the Secretary might doubt whether the program would conform to Committee policy. In that event, the Secretary and Manager would exchange views and generally would reach agreement upon a program for the day - either the Manager's suggested program or a modification.

In the rare cases when agreement could not be reached, the Manager nevertheless could act on his own initiative despite the contrary view of the Secretary. In such cases both men would summarize their reasoning in memoranda to the Committee members and would be prepared to discuss the incident at the next Committee meeting.

In case of basic disagreement regarding the advisability of transactions of substantial size and market importance - a contingency that might not occur once a year - either the Manager or the Secretary would have discretion to bring the matter immediately to the attention of the members of the Committee, for such action as the members might consider appropriate. In that rare event, an effort would be made to get in touch with all members of the Committee, and not merely the Chairman or the members located in Washington. If the problem seemed to be of sufficient importance, a special meeting of the Committee might be called to deal with it.

I have outlined these procedural details simply to show how the arrangement would work, but they are of relative insignificance. The chief value would lie in the increased responsibility of the Secretary as day-to-day interpreter of Committee policy and the benefit derived by the Manager from such regular and consistent checks upon the soundness of his operations. In other words, the program adopted by the Manager as a result of his discussions with the Secretary almost inevitably would be a program that represented the will and objectives of the Committee more effectively than if the Manager developed the program without such daily clearance with an official of equal responsibility in close touch with every phase of Committee thinking.

The suggested arrangement might strengthen the control of the Committee over the effectuation of its policies while preserving the benefits of management located in the prime money market. The functions of the two officers would complement each other, and our operations would benefit from the double check of the Secretary's intimate daily contact with Committee thinking and his detachment from direct concern with the practical problems of Open Market transactions, in addition to the benefit of the Manager's immediate and continuous knowledge of market conditions. It seems possible that a plan of this nature, modified and perfected by trial and error, might develop into an arrangement combining direct responsibility and control with practical and efficient operation, giving increased assurance that the will of the Committee is effectuated as precisely as possible.

The foregoing proposal would require the Secretary to devote all of his time to Open Market Committee matters. This seems clearly justified by the importance of our duties in the field of monetary regulation and the advisability of the closest and most efficient possible coordination of policy decisions with day-to-day operations. Consequently, the Secretary should be released from all other duties, although he would continue to be selected by the Open Market Committee from among the Board's employees and he would remain on the pay roll of the Board of Governors.

It may be said that a "two-headed" arrangement of this sort necessarily is clumsy or even unworkable. I am unable to concur in such objections. To be sure, one man in New York can make up his mind more rapidly than he and a colleague in Washington could reach a joint conclusion. However, the same argument could be made with respect to the Supreme Court, or the supervision of member State banks, or the deliberations of the Open Market Committee itself - each could be expedited if there were respectively one Justice, only one supervisor (State <u>or</u> Federal), or only one Governor or President at the head of the central banking system. Experience simply has shown that the loss in "efficiency" that results from two or nine or twelve men doing what one <u>could</u> do (as a mechanical matter) is more than counterbalanced by the benefit of acting upon the composite judgment of a multiple-member organization, where the inevitable errors of any one man's thinking can be corrected and checked by the independent thinking of others.