BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 11, 1961.

To Chairman Martin

From James L. Knipe

Subject: Reply to James Tobin's article in "Challenge," issue of January, 1961.

These comments, drafted in letter form, may be useful if attached to the reprint of the article in your file. I had not fully realized, on first skimming, just how unfairly Tobin's article was written.

In view of his new post, I suggest that you give consideration to sending him some sort of a letter, or inviting him over for lunch, or taking some other action. Perhaps such bias as he now seems to have is sufficiently important to justify action of some kind rather than to let the matter drop?

Attachment

FIRST DRAFT

Letter to James Tobin

January 11, 1961.

Dear Mr. Tobin:

Your article which appeared in the magazine "Challenge" (January, 1961, issue) deals with matters which are of great concern to us in the Federal Reserve System. I am sure you want to know how we view the facts with which you deal, and I am also confident that you welcome the expression of our opinions on the various issues under discussion.

We are, of course, in full agreement with your conclusion, that it would be most unfortunate if the Congress, the Administration, and the Federal Reserve System (a creation of the Congress) were unable to reach general agreement on broad financial and economic policies for the nation. Such agreement always has been reached, despite occasional differences of opinion on specific problems, throughout the forty-eight years of the System's existence. Over those years the System has appeared to hold views on specific matters a bit closer to those of the Congressional leadership at some times and to the Administration at other times. In every case, at least during the ten years about which I can speak with direct knowledge, I am certain that System policies have been formulated with the independent and non-partisan regard for the national welfare which is expected of us by

Congress and the Administration. Whatever inadequacies there may be in the record--and we are proud of the record--arise out of human fallibility in carrying out the difficult task of devising and implementing central bank policies which will be most conducive to the nation's economic health.

Along this line, permit me to point out, simply as an example, that significant differences of opinion have occasionally arisen in recent years, notably in 1956 and 1958, between the System and the Administration. It is not accurate for you to say, "Since 1953 the Board of Governors of the Federal Reserve and the Administration have been in uncoerced and enthusiastic agreement on the broad lines of policy." The differences which were reported in the press during the years mentioned were not the only ones which existed. Others were ironed out in the series of conferences which have been held steadily and frequently throughout the years. These conferences with Congressional leaders and Administration officials have made possible the constant airing of all problems and have resulted in what we regard as a fine atmosphere of understanding and cooperation.

The problems with which the Federal Reserve is concerned are, of course, precisely the same ones with which Congress and the Administration are dealing. Everyone with any share of the responsibility for a viable, growing American economy is eternally beset with the dilemma of how best to attain a satisfactorily high level of employment, a sufficiently rapid rate of national growth, and a reasonably stable purchasing power of the dollar.

In one sense, our share of the responsibility is more onerous simply because it is so restricted, as compared with the all-embracing power of Congress and the wide scope of Administration responsibility. Congress, for instance, can change the institutional structure in the wage-price area, if necessary, and can alter fiscal and tax policies, just as it can make statutory changes in the structure and functioning of the Federal Reserve System, if it wishes.

Looked at from another angle, our share of the responsibility is less burdensome in that we have relatively little to do with such great national issues as the foreign aid programs, and the accompanying balance-of-payments troubles. These troubles eventually plague us in our work, but all we can do is to recognize that they exist and deal with them as best we can. We do not feel that you convey a fair impression of the nation's international problems when you write, "But the dollar has come to its present pass under those very policies, administered by a conservative Administration and an independent central bank, both dedicated above all to sound finance." Surely it is not your feeling that a "liberal" Administration, and a "dependent" central bank, both dedicated to unsound finance, would have avoided the present balance-of-payments problem? You are just as fully aware as we are that the gold outflow is largely an outgrowth of the international necessities forced upon the United States if it is to play its proper role in a deeply disturbed world.

Each of us has a perfect right to hold an opinion with respect to the attitudes, motives, and philosophies of any agency or individual. You will understand, I am sure, when I differ strongly with several of the opinions which you express about the Federal Reserve. First, we do not feel that there is a ". . . single correct policy--namely the course which, within the limits of human error, the Fed pursues." I do not know of any group of men more willing to spend long hours in study and discussion attempting to mold an institution's policies to the needs of the times.

Second, I think it grossly unjust for you to suggest, "This conviction may lead the Board of Governors to resist and to frustrate any effort . . . to gear the federal budget and other instruments of economic policy to higher levels of employment and production." I am confident that, as you think over such a suggestion, you will recognize that it should never have been made. Third, in similar vein, you comment, "In the era of Eisenhower, Martin, Humphrey, and Anderson, the operative belief has been, or often seemed to be, that monetary control and debt management cannot be effective unless they are expensive, and the more costly the more effective." I cannot believe that you, as an economist, think that the rise in interest rates which always accompanies a business cycle peak was deliberately brought about by the President of the United States and some of the country's financial officials.

Fourth, in discussing the Treasury's debt-management policies, you write, "The Treasury, seconded by the Federal Reserve, has favored contracyclical variation of the maturity structure, issuing long-term obligations in place of more liquid short-term ones to fight inflation, and also issuing shorts in place of longs to combat recession." This statement is not correct. The Federal Reserve has refrained at all times, rightly or wrongly, from trying to advise the Treasury on the broad aspects of its debt-management policies.

The Federal Reserve System needs and, we believe, deserves the sympathetic aid and criticism of the Government officials who are concerned with these economic and financial matters. As a completely non-partisan organization, we are not consciously swayed in our judgments by either Party's programs or philosophies. In Committee Hearings, in conferences, and through written reports, we are constantly exposing our reasoning, so that the Congress and the Administration are always fully informed and thus in position to give advice or take any other action which seems proper to them.