

Bills Only Policy

Argument

The Federal Reserve "bills only" policy should be abandoned.

Comments

(1) The so-called "bills only" policy is essentially an operating technique for creating or absorbing bank reserves with a minimum direct effect on interest rates and prices of Government securities. In view of the fact that by far the greater portion of the System's operations are to meet short-run changes in the reserve position of the banking system, it is clearly desirable that most of the System's open market operations be confined to short-term securities.

(2) Federal Reserve officials have stated that this operating procedure is not an inviolable technique; that they stand ready to deal in longer-term securities -- and, indeed, have done so -- when conditions are appropriate. Four such instances included purchases in November 1955 and July 1958 in connection with Treasury financings, and in August 1959 and February 1960, in connection with Treasury refundings in which the System elected to exchange a portion of its holdings for the longer of two securities offered by the Treasury.

(3) To those who would argue that additional dealings in longer-term securities would be desirable, one might appropriately inquire as to the specific circumstances. There are some who would advocate that the System should under current conditions purchase long-term Government bonds and sell shorter-term issues, in order to promote lower long-term interest rates without contributing to a net increase in bank reserves. To these observers I would point out that such operations would further distort the interest-rate

structure, which has already been distorted by heavy Treasury borrowing on short term which has helped push most short-term interest rates higher than long-term rates, as a result of the interest rate ceiling. It would not seem appropriate to me to attempt to ease long-term interest rates by increasing the already heavy pressure on the short-term market, thereby favoring long-term borrowers and discriminating against borrowers in short-term markets. Moreover, this technique could only serve to pull more long-term investment money into short-term securities, thereby impeding the flow of funds into business expansion (which is so important to long-term economic growth), State and local government projects, and into mortgages.

(4) I am informed that there is a sizable group of economists who would advocate the reverse of this procedure; namely, that the Federal Reserve should stand ready to sell long-term bonds in periods of strong business activity, in order to dampen a capital spending boom. But surely, in view of the pressing need for achieving some lengthening of the maturity of the public debt, it would be preferable for the Treasury to engage in whatever modest amount of cash sales of long-term bonds would be appropriate during a period of strong business activity, rather than for the Federal Reserve to saturate such market demand as may exist for long-term bonds.

(5) There are some who would argue that the Federal Reserve should have purchased a sizable amount of long-term bonds during the recession of 1957-58. Admittedly, this was a close question of judgment at the time. But hindsight seems clearly to have vindicated the decision of the Federal Reserve not to purchase long-term securities. It is very doubtful that recovery would have come any quicker than it did, or have been any stronger. And it seems

clear that System purchases of bonds under those conditions by pushing bond prices even higher, would have engendered an even greater degree of speculation in the Government bond market than actually developed and, as we all know, such speculation was especially severe.

(6) Mr. Chairman, there is no doubt in my mind whatsoever that the Federal Reserve Open Market Committee stands ready at all times to deal in securities of any maturity, and that the so-called "bills only" policy has been misinterpreted as an ironclad rule prohibiting such operations. Thus the pragmatic question is: When would such operations be appropriate and desirable? Reviewing the history of the past few years, it seems clear to me that when such operations were appropriate, the System was quite willing to engage in them. I think the same will be true in the future.