BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 9, 1962.

To Chairman Martin

From James L. Knipe

Subject: Paper on public criticism of the Federal Reserve System.

This is a re-do, amplification, and updating of my earlier outlines of the Staff Report of the Joint Economic Committee and the Monetary Commission's Report.

Very little analysis or rebuttal has been attempted, and not much comment has been made on the material reviewed. Essentially, it is just a job of codification and summary.

I see no particular reason to distribute the paper, because it is meant mainly to refresh your mind on some of the problems. However, after you have had an opportunity to read it, please let me know if you wish to have it distributed.

Attachment

A SUMMARY OF THE PUBLIC CRITICISM

OF THE

FEDERAL RESERVE SYSTEM,

1959-1961.

February 9, 1962.

J.L.K.

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A SUMMARY OF THE PUBLIC CRITICISM OF THE FEDERAL RESERVE SYSTEM,

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CRITICISM OF THE FEDERAL RESERVE SYSTEM, 1959-'61

During the first forty years of the System's existence, from 1913 until 1953, it faced occasional outbursts of rather severe criticism but came through them apparently unscathed. During most of the later years of the period, 1940-1951, it avoided large-scale attacks by subordinating itself to Treasury dominance. During those forty years before 1953 the System had moved slowly, haltingly, toward the exercise of its function as a principal credit and monetary controller of the commercial banks of the United States. As it settled, after 1951, into this key role, the chances that it would be the target for strongly-expressed disparagement increased rapidly. An agency charged with recognizing the cyclical facts of life, and with attempting to maintain the integrity of the dollar, must be prepared to have its views and its actions challenged by many people and on many grounds.

In the postwar period, the first organized outburst on Capitol Hill was encountered in 1953, in connection with a small rise in Government security yields from the artificial levels which had been maintained during World War II and in the immediately following years. Political leaders belonging to the Democratic Party led the chorus of disapproval. In the next big debate, which took place just three years afterwards, in the spring of 1956, the more vocal critics were mainly political and business leaders belonging to the Republican Party. Their difference of opinion with the Federal Reserve revolved around the twin questions of whether or not the economy was going to remain on its high plateau, and what financial restraints, if any, should be placed on financial institutions by the monetary managers, as a part of their efforts to stop the continued deterioration of the purchasing power of the dollar.

Both of the forays, in 1953 and 1956, appeared to produce important short-run reactions in System policy, although this cannot be proven. The effects, if they really were effects, seemed to wear off each time within about half a year. As the System came into the summer of 1959, beginning of the latest series of turmoils, it showed no evidence of having had either its courage or its self-confidence weakened by the events of the preceding six years.

The most recent strife has covered a span of a little more than two years, from the spring of 1959 through the summer of 1961. First events of interest were the Hearings before the Joint Economic Committee, March-October 1959, and the last was Senator Paul H. Douglas' speech on the floor of the Senate, July 12, 1961. In between were other Hearings and other speeches. More important, two large books were produced, two books which will unquestionably stand as milestones of a sort in Federal Reserve history--the Staff Report of the Joint Economic Committee, and the Report of the Commission on Money and Credit.

The two years in question embraced the last part of the thrust and the entire plateau of the fourth postwar business cycle, the downswing of that cycle, and the beginning of the thrust of the fifth postwar cycle.

THE STAFF REPORT--JOINT ECONOMIC COMMITTEE--DECEMBER 1959

In the last week of 1959, the Joint Economic Committee published a document which received a great deal of attention, and which will be referred to, favorably and unfavorably, for years to come. The Staff Report of the Joint Economic Committee (Senator Douglas, Chairman; Representative Patman, Vice Chairman) was the outgrowth of Hearings which began on March 20, 1959, and concluded October 30, 1959. During the seven months of Hearings, one hundred witnesses were heard. Concurrently, more than twenty special study papers were written. These, added to the 488-page Staff Report, make an impressive shelf of evidence, analysis, and opinion.

It was only natural that the minority members of the Committee were something less than enthusiastic about the assemblage of material: 1/

> "In undertaking this study of employment, growth, and price levels, the Joint Economic Committee had a magnificent opportunity--a $200,000 opportunity--to define the issues, to identify gaps in our knowledge, to recommend agreed-on changes in public policy, to focus attention on the sources of disagreement, and to improve congressional and public understanding of the various goals of economic policy.
>
> "On the whole, the study itself was conducted in a competent and objective manner. The hearings were well balanced and at a high level. Many of the top economists of the profession contributed freely of their time, talents, and wisdom. A literature was assembled, both in the hearings and in the special studies, which reflects credit on the Committee, on its special staff, and on the economics profession. . . . .
>
> "These standards were not, unfortunately, maintained in the Committee's staff report . . . . We regret to say that, in our opinion, this report does not meet high professional

> standards. While there is much valuable material in it, it is marred by partisanship, by opinions and assertions not supported by the evidence, and by significant inconsistencies and serious omissions. We know from working with the special study staff that the report does not do justice to their individual and collective capacities. . . .
>
> " . . . We deeply regret that the majority are presenting a report that is partisan, cavalier about simple rules of logic and evidence, and disrespectful of legitimate differences of values, opinions, and judgments. . . .
>
> "Why should the time periods and terminal dates used in both staff and committee reports be invariably and obviously juggled to put the worst possible light on the record of the present administration, and exalt the record of previous Democratic administrations? . . .
>
> "How can a whole new set of selective controls, a theme which runs through the report, be reconciled with recommendations to make the economy more flexible and responsive to consumer demands? How can the report find market power to be a cause of inflation, requiring more vigorous antitrust enforcement for business, and yet fail to meet squarely the question of market power in the hands of unions?"

The tone for the Hearings, and for the Staff Report, was set by Professor Sumner Slichter of Harvard, first witness on the first day. He scoffed at the worries about the loss of the dollar's purchasing power in the preceding years, and pointed out what seemed to him to be the virtue of inflation: 2/

> "Creeping inflation is said to discourage saving. The opposite is true--inflation encourages saving. The reason is that the volume of saving is in the main determined by the volume of investment--not investment by the volume of saving. . . .

> "I don't think that slow creeping inflation is an encouragement to speculation so much as an encouragement to enterprise. One good thing about creeping inflation to be set over against the problems it causes is that it is a tax, and it is a tax that falls on everyone. It is not a bad kind of tax in many respects. One thing I like about it is that there are no exemptions. . . . Fortunately under inflation they pay a little tax on everything."

The third witness also assisted in setting a tone which was scarcely reassuring for those who worried about such things as the injustice already done by inflation, and the dangers of large Federal deficits in the future. Mr. Leon H. Keyserling blasted at those who let themselves be bothered in this fashion and then went on to give what was probably the simplest answer in history to the question of how proposed great public-benefit programs would be financed: 3/

> "The Chairman: . . . How would you have the expenditures met, by taxation or by financing out of a deficit?
>
> "Mr. Keyserling: Here I would distinguish between short range and long range. In the long range, the tableau of economic growth which I have presented, and the policies which I blend into it . . . point the answer to your question . . . I finance it out of economic growth."

Representative Curtis, one of the members of the Committee, was not impressed and had difficulty in following the reasoning: 4/

> "Representative Curtis: . . . Your syllogisms are advanced by so many begged questions and based upon the debris of so many straw-men you have created and then demolished that it is hard to separate the ideas out."

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While the general tone of the Staff Report may not be conducive to the development of great confidence in the financial wisdom of the authors, and many of the ideas put forward may seem unrealistic, naive, and politically slanted, the fact remains that a great deal of the writing is stimulative. The massive book is a must for those who would understand how some of the young economists were looking at the problems of the day. The top man was Dr. Otto Eckstein, 5/32, of Princeton (A.B., 1951; A.M., 1952) and Harvard (Ph.D., 1955). His doctoral dissertation had been on "Benefits and costs: studies in economics of public works evaluation," and his continuing research interest was listed as "Investment criteria for economic development; economics of water resource development."

Since the Report will be mentioned frequently in the pages to follow, it will be referred to as the "J.E.C. Staff Report," or, simply, "Staff Report." Also mentioned often, and related to the J.E.C. Staff Report, are the two reports published soon afterwards by the Committee. The first one, 6/ published on January 26, 1960, will be referred to as "Committee Report #1," and the second, 7/ published February 29, 1960, as "Committee Report #2."

REPORT OF THE MONETARY COMMISSION--JULY 1961

Second of the two books of criticism, albeit somewhat more realistic and constructive criticism in this case, was the report prepared by the Commission on Money and Credit.

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The Commission was set up in 1958, apparently as a voluntary effort on the part of the Committee for Economic Development to compromise a behind-scenes debate in Washington between the Administration (Republican) and the Congress (Democratic) as to whether the financial system should be investigated by a private group or by a Government group. The C.E.D. separated the Commission from the C.E.D. (1) by having an intervening Selection Committee to choose the Commission, (2) by asking the Selection Committee to see that the Commission contained representation of the agricultural and labor viewpoints as well as of the business and financial, and (3) by using foundations as the main source of funds.

Mr. Frazar B. Wilde, of the Connecticut General Life Insurance Company, was Chairman of the twenty-seven man Commission. Every member of the Commission was a distinguished man in his field. Included were people like Marriner S. Eccles, Adolph A. Berle, Jr., Emil Rieve, David Rockefeller, Charles B. Shuman, J. Cameron Thompson, and Theodore O. Yntema. First announcement of the appointment of the Commission was dated May 1958, and the report was published in mid 1961. Three years and, it is said, well over a million dollars went into the work. Although the report itself contains less than three hundred pages, plans are said to be on foot to publish supporting material--largely papers from academic authors--which may run up to twenty or thirty volumes.

Professor Bertrand Fox, of Harvard's Graduate School of Business Administration, was Research Director, and Professor Eli Shapiro, of M.I.T.'s School of Industrial Management, was Deputy Research Director.

Both worked only part-time at the jobs, commuting between Boston and New York. A small full-time staff was in the New York office. Professors Lester V. Chandler, of Princeton University, Paul A. Samuelson, of M.I.T., and Sumner H. Slichter, of Harvard, were three out of thirteen members of an Advisory Board. This Advisory Board cooperated closely with the Commission as a whole, as well as with the so-called Task Forces, six in number, into which the Commission divided itself.

From the beginning, it seemed likely that the Commission's contributions would be of a negative character, that is, agreement among the members would be reached more easily in connection with refusals to criticize than in connection with constructive proposals to change. This sort of thing is not to be despised, even though one would like to have more positive contributions from such an array of talent. Reasons behind a forecast of limited accomplishment were (1) the Selection Committee had leaned over so far in its anxiety to get a cross-section of viewpoints that it had made agreement on many things quite impossible, and (2) the top research people (part-time) and the advisers (part-time) would find it very difficult to condense the vast paper flow from the universities into constructive proposals which could be "sold" to the busy members when they assembled from time to time for meetings. It was clear, then, that the principal value of the final report might appear negatively, in the form of failure to condemn.

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Economists all over the United States were the beneficiaries of the contracts given to them for papers. It is possible that some of these papers may turn out to be useful, when and if they are published. Undoubtedly some, or perhaps many, of the authors resisted the temptation to polish up old papers and actually wrote new ones on their special fields of interest. It is also possible that some of the material furnished by organizations like the Treasury, the Board of Governors, the American Bankers Association, and the Life Insurance Association of America, may be of interest and value when it is made available to the public.

The report of the Commission will be cited often in the pages ahead, and it will be referred to as the "Monetary Commission Report." One should keep in mind that it was not published until a year and a half after the J.E.C. Staff Report, although preparations were organized nearly a year before the preparation began on the J.E.C. Staff Report. The J.E.C. Staff Report was in process only about nine months (March-December 1959), while the Monetary Commission Report was in process more than three years (early 1958-mid 1961). The Monetary Commission, therefore, had time to absorb everything that was in the J.E.C. Staff Report, in Committee Reports #1 and #2, and in all the other material of all kinds which appeared in 1958, 1959, 1960, and the first half of 1961.

It was generally understood that the issuance of the Monetary Commission Report was postponed until mid-1961 in order that it might appear at a decent interval after the inauguration of a new President. A careful reading of the book does not reveal anything which might not have appeared at any time, before or after an election, without creating any stir at all. Many hard, basic questions are either ignored or skimmed over with platitudes or with unrealistic assumptions. Recommendations are, generally speaking, neither new nor exciting.

Depending upon the reader's personal expectations for such studies, one might feel a sense of disappointment, and wonder how so much time and money could have produced results so meager. On the other hand, one can emphasize the usefulness of the negative accomplishment. Perhaps the failure to condemn most aspects of recent monetary policy is, in itself, a remarkable testimonial to the worthwhileness of the efforts of all the people who direct the financial activities of the country.

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The two years of criticism of the Federal Reserve System, or rather of criticism related to the functioning of the System, may be grouped under eight headings. In every case, in the eight sections to follow, an attempt is made to give the central portion of the argument, along with some supporting references or quotations. The J.E.C. Staff Report and the Monetary Commission Report will, of course, be the most frequently-cited sources.

#1 - MONETARY POLICY IS NOT VERY EFFECTIVE IN THREE AREAS

An allegation relative to the ineffectiveness of monetary policy may be directed either toward monetary policy in general, any policy, or toward monetary policy in particular, as administered by the Federal Reserve. The group of allegations which are commented on just below are mostly aimed at monetary policy in general; they do not seem to be aimed directly at the Federal Reserve. However, they have to be examined, because they are nearly always encountered somewhere in every assault made on the System.

First, there is the matter of business inventories. The upward and downward movements in the levels of inventories are so large that they exert a significant pro-cyclical influence, it is contended in the J.E.C. Staff Report:8/

> "Changes in the rate of inventory accumulation and decumulation have been an important factor in business fluctuations in the United States during the postwar period. Inventory runups in boom times have set the stage for inventory disinvestment during periods of decline, and rapid inventory disinvestment has been an important factor in the recessions of 1949, 1953-54, and 1957-58. In the last recession, a decline in nonfarm business inventory investment (seasonally adjusted annual rate) from positive $1.7 billion to negative $8.1 billion--a drop of $9.8 billion--accounted for 58 per cent of the drop in gross national product from the peak in the third quarter of 1957 to the trough in the first quarter of 1958."

The statement is then flatly made that monetary policy does not, and apparently could not in the view of the J.E.C. staff, offer much in the way of a remedy:9/

> "In any case, there is certainly no evidence that monetary policy has had any appreciable effect

"on inventory investment and its fluctuations in the last few years."

Some of the reasons mentioned[10] for the inadequacy of monetary policy in this respect are that (1) interest is ordinarily not an important element of cost in holding inventories, (2) since this is a favorite type of loan in the eyes of most commercial bankers, it would be hard to restrain them from granting such loans, and (3) even if the commercial banks were restrained, the industrial companies could probably finance inventory investment by liquidating cash balances or by selling Government securities or by borrowing elsewhere.

As to remedies outside of general monetary policy, the J.E.C. staff reaches back,[11] half heartedly, for two old ideas. One is a variable secondary reserve requirement, which would permit governmental locking up or releasing of certain categories of banking assets. The other is the basing of reserve requirements of commercial banks on different types of assets, rather than on liabilities, thereby affording a new type of governmental control over the shifting of commercial banks' assets. Both proposals are beset with practical problems of administration which are great enough to give any practical banker the shakes.

It would seem that the Joint Economic Committee may have realized that its staff had been spending some time in a rarified, Utopian atmosphere, because in Committee Reports #1 and #2 inventories are not even mentioned.

When the Monetary Commission got around to contemplating the inventory matter, it commented on the nature of the problem for one-half page and then skittered away with:[12] "It may well be that more effective controls of such expenditures than general credit measures will be necessary to achieve our major economic objectives, and the Commission suggests that possible methods of influencing inventory and business equipment expenditures on a selective basis be investigated by the Government." The Commission evidently felt that the time, money, and talent at its disposal were not adequate to tackle the subject of how to control business expenditures on inventory through the use of financial mechanisms.

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A similar situation presents itself in the case of business spending for plant and equipment. Businessmen and their bankers are eternally surprised when they discover every three or four years that there is a business cycle and that they have, by bunching their spending at the top and by unduly reducing it at the bottom, been the principal contributors to making the cycle. Sheep-like behavior of this sort is, in part, an inevitable result of a system of highly-capitalized production. If the country is to have the benefit of goods manufactured with complex machinery, it would seem that it must put up with the consequences of the guesswork involved in trying to estimate volumes in consumers' goods markets several years in advance. Not all of the imitative behavior of the industrial executives can be explained away in this fashion. Part of it comes from close contacts through trade associations and other group activities, plus their traditional competitive conformity. Whatever the origins of the unfortunate habits, the habits seem to be inextricably tied up with the magnificent dynamism of the American economy. Industrialists would unquestionably be less happy in the aggressive management of their plants if they were ever to lose the right to be wrong.

The J.E.C. staff finds, as it found in the matter of inventories, that general monetary policy is not very effective in exercising influence over the total volume of corporate expenditures for capital equipment:[13/]

> "It seems fair to conclude that while changes in interest rates and credit availability brought about by monetary policy have some marginal influence over business investment expenditures, these effects are so weak that they are commonly swamped by the dynamic forces of innovation, surging business activity, and rising profits . . . it is very doubtful whether restrictive monetary policy did more than touch the fringes of the private investment boom of 1955-57."

Evidence[14/] is marshalled by the staff to support the widely-recognized fact that the spending on plant and equipment is either not influenced much by interest rates or is actually influenced perversely, i.e., the spending increases as the cost of money goes up. Reasons are listed[15/] as follows: (1) a large percentage of the funds spent for plant and equipment are obtained internally, (2) the prospective returns from capital profits are ordinarily so high relative to returns on safe financial assets that the comparison is practically meaningless, (3) management does not have time, anyway, to familiarize itself with outside financial investments, and[16/] (4) "The existence of unexploited monopolistic profit opportunities permits such companies to raise prices to their customers in order to pass along any increased interest costs they may incur."

As to additional steps which might be taken, beyond the usual monetary actions, the staff does not come up[17/] with anything which seemed even to be satisfying to itself. After mentioning briefly the possibilities of reducing the deductibility of interest under the corporate income tax (to increase the influence of changes in the interest rate), and of re-imposing the tax on undistributed profits, they proceed to the thought that the Federal Reserve might take a more positive attitude toward influencing the long-term rate of interest through purchases and sales for the System portfolio.

In view of the severe criticism of so-called high interest rates throughout the entire Staff Report, the implications of this proposal would appear to be inconsistent with the rest of the Report in that the Federal Reserve would presumably be expected to try to run long-term interest rates up considerably higher than they have been at the tops of recent cycles. Evidently these considerations came to mind very quickly, because on the next page the writers back away from the proposal--mentioning the effects of such higher interest rates on State and local government financing, and concluding "On the whole, the institutional changes required, together with the problems which would arise and the fact it is by no means certain that the controls, even under the best circumstances, would be effective, make the feasibility of this approach seem rather doubtful."

Here is a classic example of the difficulty of finding soft answers to hard problems, in the staff's attempt to discover at least one way to restrain excesses in expenditures on plant and equipment. Higher interest rates, they point out, might help to restrain certain expenditures of which they (the writers) disapprove, but these rates might also help to restrain certain other expenditures of which they approve. How much simpler life would be for them if this great roaring beast of an economy would only lie still so that some of them could give it a stimulative hypodermic in one part of its body while colleagues simultaneously wrapped a tight elastic bandage around some other part.

Other suggestions which are mentioned[18] are a selective control over investment holdings of all financial institutions, a selective control over capital expenditures by a system of variable depreciation allowances, and a selective control over corporations through adjustments in their tax rates.

At the end of all of this meditation, the reader senses acute unhappiness on the part of the staff. This is an area which plays a vital role in the expanding American economy and it is an area in which clearly, to analysts of the staff, there is too much exercise of the prerogatives of freedom. And yet, they must admit that no centralized, specific control appears practicable:

> "We may conclude that, while the proposals referred to above and others as well are worthy of study, it is by no means clear that it would be either desirable or feasible to apply selective controls on plant and equipment. Some instability may be the price we have to pay for a generally high rate of capital development; moreover, it is by no means certain that controls would be effective in preventing instability."

The Joint Economic Committee again, as in the case of inventories, apparently came to the conclusion that its staff had been playing around with ideas which may have looked fine on paper but which might do more harm than good if tried out in the real world. Plant and equipment expenditures were barely mentioned in Committee Report #1, and were ignored completely in Committee Report #2.

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It has already been noted above that the Monetary Commission dismissed the whole subject with the suggestion that it ought to be investigated by the Government.

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Last of the three areas in which monetary policy is labelled as ineffective is the field of consumer credit. As the total outstanding credit to consumers has soared to previously unbelievable heights, and as borrowing has become indispensable to so many millions of people in maintaining what they believe to be their proper standard of expenditure, it has clearly become an economic phenomenon of great importance. Growth of this practice of "spend now, save later" has made it possible for consumers to exercise some of the spending discretion formerly reserved for business executives, and so to engage in similar herd behavior. Mob action of any kind is always disruptive--whether it be on a ship, or on a street, or in the economy of a powerful industrial nation. The staff of the J.E.C. speaks bluntly:19/ "Consumer durable goods, particularly automobiles, have contributed significantly to economic instability during the postwar period." Two pages later: "Thus, it appears that it is the instability--the rapid accelerations and decelerations--in the growth of consumer credit rather than the high average rate of growth per se that constitutes the problems. Consumer credit has contributed to most of the fluctuations in economic activity since 1929."

The bad effects of too-rapid movements in consumer credit are emphasized with respect to the sequence of events in the years 1955 through 1957: "A boom in consumer durable goods, especially automobiles, powered by a rapid growth of consumer credit, in 1955 seems clearly to have been a factor in the inflationary expansion of 1956 and 1957, both through its effect on profits and on the three-year wage settlement negotiated on the basis of them, and through its effect on other industries. Moreover, the excessive expansion in the automobile industry in that year set the stage for the unemployment and stagnation in that industry in the ensuing years . . . And, finally, the automobile expansion of 1955 undoubtedly helped to power the boom in plant and equipment in 1956 and 1957, which eventually resulted in overcapacity and unemployment."

As to the remedy, most economists in the United States are aware of the disillusionment of the Federal Reserve people in connection with enforcement of retail-type Regulation "W". They are also aware that the Federal Reserve has chosen not to take any leadership in working out plans for an entirely different, wholesale-type regulation. Very few economic thinkers would ever again advocate a retail-type regulation but probably a majority would go along with the J.E.C. Staff Report in proposing that consideration be given to a new approach to an important problem:20/

> "For example, controls applied to the supply of funds to sales finance companies by limiting their borrowings might be more satisfactory if combined with similar controls over the ability of commercial banks to make consumer loans."

In sharp contrast to the reticence shown by the Joint Economic Committee in following up its staff's ideas with regard to business inventories and capital expenditures, it spoke vigorously in Committee Report #1 on the subject of consumer credit:[21]

> "We recommend that legislation for standby regulation of the downpayment and of the maturity terms of consumer loans be enacted . . . sudden surges of consumer credit have from time to time been an important source of instability . . . . Further, the rapid rate of expansion of consumer loans in some periods has contributed to inflation through its effect both on prices and wages."

The Monetary Commission did not choose to take any stand on this vital subject. In its Report it was almost as casual and inconclusive as in the matter of business inventories and capital expenditures. After a rambling, one-page[22] discussion, the whole thing was dismissed:

> "The Commission is almost evenly divided as to the desirability of granting standby authority to the Federal Reserve Board for consumer credit controls. In the absence of a consensus, no recommendation is made except to urge an investigation of better forms of such controls which could be administered more effectively if they should be needed."

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A selective control over consumer credit, even if it were of a wholesale-type, and skillfully designed, is something which would likely be extremely unpopular unless the country were engaged in a major war. Even a prestigious, self-confident group like the Monetary Commission shied away from making any recommendation. On the Joint Economic Committee there were dissenting views expressed by Mr. Patman[23/], disagreeing with his own majority's recommendation. It would seem, therefore, as though the Federal Reserve will not have to face up to a strong demand for consumer credit controls within the very near future. If the System does not take it on itself to design an improved set of controls, however, it will be just as unprepared as everyone else when, and if, the controls become a necessity.

So far as the criticisms relative to business inventories and capital expenditures are concerned, it also seems obvious that no organized attack will develop within the predictable future. So, again, if the Federal Reserve wishes to procrastinate in its planning and testing until it faces an aroused public demand, or a national emergency, it can do so without any imminent danger of public embarrassment. If, on the contrary, the System wants to anticipate the problems of the coming years, it could assign some analysts' time to a thorough study of selective controls in the three areas where general monetary policy is alleged to be ineffective.

#2 - MONETARY POLICY IS TOO EFFECTIVE IN THREE OTHER AREAS

Some critics of monetary policy find that it is not very useful anywhere; they think it is always either too weak or too strong. The staff of the Joint Economic Committee was of that school. Apparently they felt that no matter how brilliantly monetary and credit controls might be managed, they are not up to the job in a modern economy:24/

> "It is quite plain that if general credit controls affected all sectors equally (in some sense), they would still be quite unsatisfactory as a stabilization device, because we do not want equal effects everywhere at all times. If we want to improve the performance of stabilization policy significantly, it is necessary to move in the direction of greater selectivity. This has been apparent for some time, but the other findings of this study should increase our awareness of it. General controls are a mirage and a delusion. It is perhaps just as well that monetary controls have not been very effective; if they had been, they might have been disastrous." (underlining supplied)

One of the fields in which the J.E.C. staff sees general monetary policy as having been too effective around the top of the business cycle is residential housing. They do not come by the opinion easily, because a look at the evidence leads one to judge that monetary policy has been successful in recent years in producing countercyclical movements in housing volumes:25/ "The interesting thing about these fluctuations is that they have been distinctly anticyclical, with residential construction rising when the rest of the economy was declining and declining when the rest of the economy was rising . . . residential construction has behaved in a contracyclical fashion and, in the aggregate at least, has contributed to economic stability."

Having said these good words about monetary policy, the J.E.C. staff hastens to point out that this performance, satisfactory as it might look, was not good enough. Something nearer perfection might have been attained, they think:26/

> "What we know about the behavior of prices and wages in the construction industry suggests, however, that the cutback in housing construction in 1956 and 1957 may not have contributed much directly to the prevention of inflation. And the high level of unemployment in the construction industry during this period seems to indicate that much of the labor released from housing construction failed to find employment in other branches of the industry. These considerations suggest that if mortgage credit had been more liberally available, we might have been able to have somewhat more residential construction without very much more inflation. To be sure, there would probably have been somewhat more pressure on the prices of certain building materials that were in short supply and there would have been some additional inflationary pressure from the respending of the additional income generated in residential construction, but there is little reason to suppose that these effects would have been large."

Probably the main reason why housing volumes moved as they did in those years--a useful movement, it seemed to many analysts, but not useful enough in the eyes of the J.E.C. staff--was that the Federal Government sets interest rate ceilings on guaranteed loans:27/

> "The pronounced impact on housing since 1953 is chiefly due to the existence of a rather peculiar but very simple mechanism. Due to ceilings on the interest rates that may be charged on mortgages insured by the Federal Housing Administration and guaranteed by the Veterans' Administration, a rise in yields on other competitive types of investments, such as corporate and Government

> securities, has tended to attract the supply of investment funds away from these mortgages. On the other hand, when credit conditions have eased and yields on competitive investments have fallen, the supply of investment funds has tended to flow back into the Government-supported mortgage programs."

Having developed this point that residential construction had responded satisfactorily, or perhaps too satisfactorily in the view of the writers, to general monetary policy, they then start to theorize as to what might happen (1) if the trend toward use of conventional mortgages were to speed up, and (2) if the ceilings on interest rates charged under Government-supported programs were to be removed. In such case, they contend,28/ "It does appear . . . residential construction would continue to show significant fluctuations. But instead of behaving in a contra-cyclical fashion, as has been the case in the last few years, it seems likely that the income effect would dominate and the fluctuations would be procyclical, thus contributing to over-all instability."

Postulating these altered conditions, the writers move over to the other side of the debate and, instead of implying that monetary policy has exercised too great a restraint on housing, they contend that a selective control is needed because,29/ ". . . housing construction is capable of powering an inflationary boom which would affect other sectors of the economy, and there should be some way of preventing this." After considering whether it would be better, if this situation were to be encountered, to ". . . keep the present interest rate limitations, recognizing them frankly as a selective credit control, and manipulating them accordingly, or to adopt another kind of selective regulation . . .", they come to the conclusion that ". . . it would probably be preferable to eliminate the interest rate ceilings and adopt the other form of controls. . . ."

Perhaps the Joint Economic Committee was able to follow the reasoning of its staff, which may be summarized as follows:

(a) General monetary controls have worked quite well,

(b) Really too well, but if interest rate ceilings on mortgages were removed,

(c) Monetary controls would not work so well, so

(d) A new system of controls must be devised to replace the "interest rate ceiling cum monetary controls" of the present.

On the other hand, possibly the Committee was not able to follow the reasoning. At any rate, the whole subject was accorded only the briefest mention in Committee Report #1:30/ "Present general tools primarily affect residential construction, as well as small business and State and local governments. Credit for consumers and the supply of funds for most business investment are very little affected by monetary policy. Therefore, the effect of the general policies has in fact been selective, penalizing the investment for housing, for schools, and for small business. . . ." The Committee's stance, therefore, is that monetary policy has been too effective with respect to housing, whereas the staff had labored principally to develop the thesis that it would not be effective enough after certain institutional changes which might possibly take place sometime in the future. The Committee does not mention the matter at all in Committee Report #2.

The Monetary Commission is equally brief and equally unclear in its treatment of residential construction. There is a weak statement on page 59, and a vague implication, on page 75, that the countercyclical movements of housing volumes in the last few years have been deemed to be satisfactory. There is another sentence on the same page which implies the desirability of some new kind of a selective control if interest rate ceilings are ever removed. On page 208, the Commission recommends the abolition of ceiling rates. However, on page 204, the Commission recommends "that the FHA and VA underwriting programs be used to aid in implementing the countercyclical and price-stabilizing policies of the government by variations in the terms of the underwritten loans . . . ."

It would appear as though the Federal Reserve will not be confronted by any well-organized, well-planned program of critical comment, from any source, in support of an allegation that general credit and monetary policy is too effective in the field of residential construction. If the ceiling rates are removed, though, at some time in the future, there would be need at that time for a Federal Reserve study of whether or not it would be wise to supplement monetary policy with additional control devices, in the field of housing.

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Another place where the J.E.C. staff finds monetary policy too effective in its restraint phase is with small business concerns. Obviously, insofar as smallness is associated with marginality of credit risk, smaller businesses will find it is somewhat harder for them to raise money at the top of the cycle than it is for their larger competitors. The same thing is true at the bottom of the cycle. Until the world is remade into one of perfect equality among all men and all corporations, this is not a startling discovery. Unless some great and manifest injustice is done in the process, the phenomenon is not one which justifies criticism of the central bank or of anyone else.

Even though one's common sense tells him that small businesses must always find money a bit harder to raise than do their larger competitors, the remarkable dispersion and penetration of banking services of the United States has gone a long way toward reducing the differential. As a result, evidence to sustain the thesis of abused small business--even if attention is directed only toward conventional banking facilities and the Federal Government's special programs are ignored--is not easy to assemble. As stated in the Staff Report:31/

> "However, as to whether there has in fact been such discrimination in the last few years, the evidence is mixed, difficult to interpret, and highly unsatisfactory."

An example of how hard the staff was straining to support its thesis of economic injustice worked on small business is this quotation from the Staff Report relative to interest rates:32/

> "It does appear that during this period interest rates on loans to large businesses rose substantially more than interest rates on loans to small businesses. In a sense, this was favorable to small businesses, but basically it probably hurt them by making loans to small business less attractive than loans to larger concerns."

If the evidence had shown that the interest rates on loans to small business had risen more, rather than less, it seems likely that the same answer would have been found, i.e., that small business had been injured unfairly. When a group of analysts has decided on the way something should look, it is usually possible to move around until one sees it that way.

The conclusion drawn by the J.E.C. staff was not justified by the evidence adduced. It is simply an unsupported personal opinion:[33] "That is, if monetary policy works chiefly through availability and if availability is not a problem for large firms, it follows that when monetary policy is effective in curtailing business spending, its impact must fall mainly on small business."

The Joint Economic Committee itself made only the scantiest reference to the matter, as quoted above in connection with residential construction.

The Monetary Commission Report discusses the matter briefly and on page 58 makes the fairly flat statement: "Bank credit rationing did occur and was not uniform. But the criticism for rationing did not appear to be size of firm."

The Federal Reserve should presumably always be alert to "discrimination," using the word in a reasonable way and without any suggestion of an attempt to impose an obligation for making noneconomic judgments on the private loaning institutions, but there seems to be no justification for expecting the System to undertake vast new studies in this area of the economy.

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The third area which bothers the J.E.C. staff is that of State and local public projects, schools, hospitals, and other public buildings. Here again, the staff[34] seems to be struggling with facts which either point in a direction which seems to them wrong, or else do not point at all. To cite one example: "Expenditures on new construction by State and local governments increased steadily during the period of tight credit in 1955-57—from $7.8 billion in 1954 to $9.7 billion in 1957." And another: "A study by the Investment Bankers Association, covering the 9-month period July 1956 to March 1957, indicated that about $0.5 billion of bonds were not sold as scheduled, but a substantial portion of these were reoffered and sold at a later date during the period." And still another: "There are signs that in some instances State and local governments . . . are becoming more sensitive to interest costs, but there are also a great many instances where interest rates do not influence decisions at all. In some cases, there are legal ceilings on interest rates that can be paid by governmental units, but apparently these ceilings are commonly set at 5 or 6 per cent and are thus high enough so that they do not interfere with the raising of funds."

Faced with these stubborn facts, it is necessary for them to look elsewhere to find some kind of backing for the thesis that general monetary policy had been too restrictive. An unfinished study is said to find evidence ". . . of systematic contracyclical behavior on the part of

State and local government construction expenditures in recent years. This study . . . concludes that monetary policy has a contracyclical effect on State and local expenditures which is approximately one-third to one-fourth as great as the effect on residential construction." Clearly not satisfied with that scarcely damning indictment, a paragraph on school needs was inserted, concluding with this expression of opinion: "Thus, in a period in which school facilities were generally recognized as inadequate to begin with, in which there have been increasing increments to the school-age population, and in which construction costs have been rising sharply, we find an apparent decline in expenditures on school construction. One might surmise that the tight money that has prevailed during most of this period has had something to do with it."

If monetary policy had been unduly restrictive on State and local expenditures, the contention could not be proven by the evidence cited. It was surely prudent for the writers to insert a hedge clause at the end of their conclusion: "Aside from this sector (residential construction), the effects of monetary policy have probably been greatest on State and local government expenditures . . . although the evidence . . . is far from definitive."

It has already been mentioned that the Joint Economic Committee, in its Report #1, referred to this class of expenditures in only one sentence.

The Monetary Commission Report does not treat the subject at all.

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One must conclude that, on the basis of the evidence reviewed by the J.E.C. staff, there is no reason for the Federal Reserve to feel that general monetary policy has imposed, or is likely to impose, any unfair or unwarranted restrictions on State and local public projects.

#3 - THE FEDERAL RESERVE SYSTEM IS NOT EFFICIENTLY INTEGRATED INTO THE ADMINISTRATION.

The J.E.C. Staff Report did not take up for consideration the relationships between the Federal Reserve System and the Executive Branch of the Government. Neither did the Joint Economic Committee itself, in its two Reports. Congressman Wright Patman, however, never seems to tire of the theme and he periodically makes speeches, or issues statements, with regard to the situation as he sees it, regardless of whether or not the rest of the Committee majority expresses interest. A typical comment is contained in an appendix to Committee Report #1,[35] "The Supplemental Views of Representative Wright Patman":

> "The Federal Reserve System should be brought back into the Government from whence it has seceded, so that its economic policies may be coordinated with economic policies arrived at by constitutional means and so, too, that some branch of the Government—the executive or the Congress—will have political responsibility for its political decisions."

Mr. Patman touched on the same relationship when, on June 2, 1961, he was questioning[36] Mr. Alfred Hayes, president of the Federal Reserve Bank of New York:

> Chairman Patman. . . . I think that the President of the United States, under the Constitution, is dutybound to take care that the laws are faithfully executed. The Federal Reserve Act is a law just like any other law, and since the President of the United States has asked you gentlemen, this is what I consider a direct statement to the Federal Reserve System, the Federal Reserve Board and the Open Market Committee, in particular, to, "Not choke off recovery . . ."
>
> Mr. Hayes. Let me say this, Mr. Patman, I have the utmost respect for the President and the utmost respect for anything he says. But I would also like to point out that in the wisdom of Congress they set up the system in such a way that the system is not under the instructions of the executive branch of the Government.
>
> Chairman Patman. Listen, you are seceding more than you have ever seceded. I thought you seceded pretty well on March 4, 1951, but you are going further, I think, than you did then.

The Monetary Commission, in its long deliberations, devoted a great deal of attention to the problem and brought forward some rather drastic proposals for changes. To say that the Monetary Commission had accepted the Patman view of what ought to be done would be an exaggeration, but to say that the Commission, apparently for quite different reasons, produced some comparable recommendations, would seem to be a fair statement. Certainly the Commission's recommendations, if followed, would move the relationships a long way toward making the System a directly-reporting department in the Presidential hierarchy.

A reader of the Monetary Commission Report gets the feeling that the Commission did a lot of soul-searching before it came to such a decision. For example, it pointed[37] out that: "A strong advocate for the claims of monetary stability is needed within the government, and the central bank is the natural home of such advocacy. A measure of independence from the Treasury with respect to support of the Treasury securities market is a requisite too, if the central bank is to exercise effective monetary control."

However, after looking at arguments on both sides of the question, the Commission concludes:[38]

> "No doubt there are occasions and types of pressure that need to be guarded against . . . The need for coordination, however, is very important. Isolation may mean weakness, and presidential support can be very helpful at times. The real ability of the System to influence national economic policy might well be increased rather than diminished if its ties to the President were closer. The Commission believes that somewhat closer ties are advisable."

Recommendations made by the Commission to bring about "somewhat closer ties" are six in number. It is impossible to know which, if any, may turn out as most likely to receive serious consideration by Congress or which would, if put into operation, bring about the most significant alteration in System practices. The order and grouping, below, represent the writer's effort to re-arrange the recommendations of the Commission somewhat more meaningfully than the way they are presented in the Report.

First, it is recommended[39] that ". . . the Employment Act be amended to provide that whenever in the President's judgment the current economic situation, as revealed over a span of time in the indicators issued from his Executive Office or on the basis of other information, shows a tendency significantly counter to the objectives set forth in the Employment Act as amended, and at least quarterly thereafter for so long as the unfavorable tendency prevails, the President shall supplement his annual Economic Report with a statement setting forth: 1. His understanding and assessment of the factors in the economy contributing to the unfavorable tendency. 2. The steps being taken by him and by government agencies, including the Federal Reserve System, to use existing instruments and resources available for better achieving the goals of the Employment Act as amended. 3. Explanations for any seemingly inconsistent use being made of any of these instruments . . ." This item #3, particularly, appears to be aimed directly at the Federal Reserve in connection with the allegation that the System is sometimes out of step with the rest of the Government.

Second, the Commission proposes[40/] that an Advisory Board be created by the President, perhaps with the Chairman of the Council of Economic Advisers as Chairman. Included in the membership would be the Chairman of the Board of Governors, and the Secretary of the Treasury. Since the meetings would be attended frequently by the President himself, the heads of the various agencies would feel obligated to put in personal appearances at each meeting. The Commission says: "This would make the CEA Chairman less than a cabinet member but more than an executive secretary . . ." Many people might feel that it would do even more toward enhancing the power and prestige of the CEA Chairman, largely at the expense of the power and prestige of the Secretary of the Treasury and the Chairman of the Board of Governors.

The third proposal[41] is regarded by some observers as the most important of the six. It is: "The FRB Chairman and Vice-Chairman should be designated by the President from among the Board's membership, to serve for four-year terms coterminous with the President's." Persons not familiar with a board's (Federal Reserve or any other Government board) functioning might doubt that this would be a vital change. They could cite the facts (1) that the Reserve Board Chairman's statutory powers are not great now, (2) that he is simply an equal among his peers in voting, and (3) that a new President might ordinarily choose from among members already on the Board. All of these are valid points, but several other points are missing. A new chairman of any board can always, even if he is lacking in ability and forcefulness, exercise a great deal of subtle control through such devices as (1) preparation of the agenda of meetings, (2) timing and duration of the meetings, (3) postponement or advancement of issues to be considered, (4) encouragement or discouragement of minority viewpoints, (5) delivering of speeches, granting of interviews, and carrying on of conversations outside, and (6) general supervision of staff material presented for consideration to his board. Therefore, the appointment of a chairman by an incoming President could conceivably, under circumstances easily visualized, be an important factor in changing the philosophy, policies, and practices of the Board of Governors of the Federal Reserve System.

As a fourth recommendation, presumably related to the possibility of the Board's becoming more directly under the control of the President, the Commission suggests[42] a large increase in the Board's powers: "The determination of open market policies should be vested in the Board. . . The determination of the rediscount rate (the same for all Reserve banks) should be vested with the Board." In cutting down the power (or perhaps snuffing out the life) of the Open Market Committee, the Commission writes[43] with dogmatic confidence on a subject which is not that simple: ". . . the distinction between the Board and the Federal Open Market Committee has outlived its usefulness. The exercise of the System's three main powers should be complementary and governed by the same considerations, that is, by the same people in the same forum . . . the decisions of the Board are exercises of public regulatory authority, and there should be no ambiguity about where the responsibility for them lies: it belongs exclusively in the hands of public officials." The Report does not comment on the relative economic competence likely to be expected of the men in the two groups, Presidents and Board, or on whether or not there is an advantage in having some votes cast by men whose base of operations is outside of Washington.

The fifth proposal[44] would, among other things, make it easier for the President to name appointees to the Board as he pleased: "Occupational and geographical qualifications for Board members should be eliminated. Instead the statute should stipulate that members shall be positively qualified by experience or education, competence, independence, and objectivity commensurate with the increased responsibilities recommended for them in the achievement of low levels of unemployment, an adequate rate of economic growth, and reasonable stability of price levels . . ."

As the sixth recommendation:[45] "The FRB should consist of five members, with overlapping ten-year terms, one expiring each odd-numbered year; members should be eligible for reappointment. This would assure the President of one vacancy to be filled shortly after his inauguration . . ."

There could not be much doubt that these six recommendations, if accepted by Congress, would bring about "somewhat closer ties." It is clear that, in the Commission's opinion, this is a good thing. The Commission rejected[46] some of the counter-arguments, with what reads like scorn: "Some arguments for independence are more or less frankly anti-democratic in their premises. For example, it is said that anti-inflationary measures are unpopular though necessary, and therefore the best assurance of being taken is by 'endowing the Board of Governors with a considerable degree of independence,' or that 'hard' decisions are more acceptable to the public 'if they are decided by public officials who, like the members of the judiciary, are removed from immediate pressure.'" Other students of the art of practical politics may see more to such arguments than was visible to the Commission.

The six recommendations put forward by the Monetary Commission might be taken more lightly if they had come from a group within which there was known to exist a pro-inflation, anti-sound-money bias. A group of that sort would be expected to want to change the Federal Reserve structure in drastic fashion. Coming from a group which seems to have approved, in general, the System's economic policies of recent years, and which would appear to be anything but anti-sound-money, the suggestions must be regarded as deserving of close study. Surely it has to be assumed that the Commission felt that the System could function more smoothly and could continue to do its job with unimpaired efficiency only if it were thus brought more closely under the immediate direction and "protection" of the President of the United States.

#4 - THE FEDERAL RESERVE SYSTEM IS NOT ORGANIZED TO FUNCTION EFFICIENTLY.

As sketched in the preceding section, the criticisms and suggestions as to the System's place within the governmental scheme of things have largely originated with the Monetary Commission and with Mr. Patman, rather than with the Joint Economic Committee or its staff. As one moves down into the internal organization of the System, and into its day-to-day operations, the ideas about weaknesses, and needed changes, are furnished both by the staff of the Committee and by the Monetary Commission.

The distribution of powers within the System, as well as the functioning of the Federal Open Market Committee, are not considered entirely satisfactory by the Joint Economic Committee's staff:47/ "The present administrative arrangements within the Federal Reserve seem to be unduly cumbersome. Primary responsibility with respect to the discount rate lies with the individual Federal Reserve banks; changes in reserve requirements are made by the Board of Governors; and open market policy is administered by the Federal Open Market Committee. . ." No words are wasted in the Report's flat recommendation: ". . . it would be desirable to put the administration of all the credit control weapons in the hands of the same agency."

Another organizational feature which the staff does not like is the way in which the Open Market Committee functions. How a commentator can write with such confidence about something with which he could have had no direct experience is an interesting question.

> "A body of 12 members is a rather cumbersome administrative organ, and the clumsiness is greatly increased by the presence of numerous other persons. Some streamlining of this complex machinery would seem to be in order. It seems possible that some of the self-imposed limitations on the System's freedom of action, such as the bills-only policy, are the result of arriving at decisions on complex matters under such conditions. Perhaps a reduction of the size of the Board of Governors and the concentration of authority with respect to all of the policy weapons in the hands of this group, with representatives of the Reserve banks serving only in an unofficial advisory capacity (if at all) would be desirable. Some reform along these lines is vitally necessary if a more complex policy involving the use of selective controls is to be put into operation."

In item #4 of the section just preceding this one, a quotation[48/] from the Monetary Commission Report showed that the Commission essentially accepted the J.E.C. staff's viewpoint on the Federal Open Market Committee, the distribution of powers, and what ought to be done about these things.

The Monetary Commission, though, goes far beyond the area covered by the J.E.C. staff, into the operations of the Board. Here the Commission speaks with the authority of men who are chief executive officers of large and profitable business enterprises:[49/]

> ". . . the Board has suffered from a malady that has plagued the other independent regulatory commissions, a congestion of detailed business at the top, to the detriment of the time and energy Board members can devote to the broad issues of monetary policy.
>
> "The FRB Chairman should be the chief executive officer of the Board, empowered to handle administrative matters. The law should be clarified to authorize the Board to delegate to Board committees, or to Board members individually, or to senior staff officers of the Board, any of its functions in the administration of its powers in regard to the supervision of the banking structure, such as the Bank Holding Company Act, the anti-trust laws in regard to mergers, and applications for charters and branches . . ."

Another matter of operational efficiency is the reporting which the Federal Open Market Committee and the Board do, to the Congress and to the public. Although neither the J.E.C. staff nor the Committee dealt with this subject, Mr. Patman has done so, as has the Monetary Commission. In the Hearings 50/ before the Joint Economic Committee, June 1, 1961, Mr. Patman was questioning Mr. Martin:

> Chairman Patman. . . . I do not see how the ordinary, average person could possibly interpret what the language means. It is really, and I say this respectfully, it is gobbledygook.

The Monetary Commission stresses the necessity for timeliness and completeness, and by implication clarity, in the reports issued by the System: 51/

> "The case for more complete and timely disclosure is partly that accurate information would perhaps be less dangerous than the rumors that are continuously circulating about what the Federal Reserve policy is today or is likely to

> be next week. In the absence of adequate knowledge, those interested in such matters have a tendency to seize upon even the most outlandish rumors as significant . . . Another argument for more complete disclosure is that monetary policy represents one facet of national economic policy, and in a democratic society public policies should be subject to current debate.
>
> "Although there is no easy solution to this issue, the Commission believes that the Federal Reserve should follow the general rule that the public should be kept informed with reasonable promptness and with reasonable detail of the reasons for its major policy decisions and actions in order to avoid misunderstanding and misinterpretation."

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When it comes to consideration of the way in which the System functions, it can be seen that there is a large amount of agreement between the economists on the Joint Economic Committee's staff and the business and professional leaders on the Monetary Commission. Both groups question certain organizational patterns and operating practices, although the Monetary Commission probes much deeper. The Monetary Commission also takes a strong stand with respect to the desirability of more and better reporting.

#5 - FEDERAL RESERVE OPERATIONAL RESULTS ARE HANDICAPPED BY SLIPPAGES, TIME LAGS, INADEQUACIES, AND AMBIGUITIES.

The criticisms noted in this section under "slippages," "time lags," and "ambiguities" are, generally speaking, ones which might apply to any central bank's operations and so tend to be arguments either for greater use of selective controls or for the wider use of automatic or semi-automatic devices. Under "inadequacies," the Federal Reserve's so-called "Bills Only" policy is examined.

First, the matter of "slippages."[52/] One line of thought which intrigues some critics of the Federal Reserve is to the effect that the financial community is so clever that it can often successfully nullify or delay the effects of policy action taken by the Board or by the Federal Open Market Committee. Sometimes the same commentators will be heard five minutes later declaiming on the unholy power of the Federal Reserve, with no apparent comprehension of their inconsistency.

In the Staff Report, these so-called "slippages" are commented on at some length, with understanding, and without any accompanying proposals to try to do away with them or to attempt anything impractical in the way of counteracting them. One gets the impression that the staff is realistic in contemplating the "slippages"--aware that even so gentle and general a control as that exercised through a gradually-tightened reserve position would probably be disturbing if the financial community were not able to counteract its application to some degree. The most obvious of these actions which can be taken is the borrowing by member banks from the Federal Reserve, thereby temporarily maintaining a level of total reserves at a time when the System is lowering the level of non-borrowed reserves. This is not mentioned among the "slippages" in the Report, because the writers are addressing themselves to the various ways by which the business community itself steps up the efficiency with which it employs its cash, i.e., increases the velocity of the available money supply and thereby counterbalances the effect of a reduced or unchanged supply of money. The principal actions which result in more efficient use of money are shifts in portfolio composition between various investing groups in such a way as to produce maximum turnover of cash balances. The most meaningful of the shifts is probably that made by the commercial banks when they sell large quantities of Government securities in order to add to their loan totals.

The Staff Report concludes:53/

> "There is not much that can be done about this propensity of the financial system to be ingenious. It is a matter of numerous small adjustments, frequently quantitatively unimportant individually, but cumulatively constituting a significant 'slippage' in our monetary controls. Moreover, it would probably be unwise to interfere with these developments even if it were possible to do so, since they have served to increase the mobility of funds, reduced interest rate differentials, and caused the market mechanism to perform more efficiently . . ."

The Monetary Commission Report does not give much space to this matter. In the discussion of whether or not the Federal Reserve should be given control over nonbank financial institutions, it is stated:54/ "The evidence, for either the cyclical or the secular periods, does not support a case for an extension of the direct monetary controls over nonbank financial intermediaries. Their contribution to cyclical changes in velocity appears to be too small to warrant such an extension. Their effect on velocity over the long run can easily be taken into account in regulating the long-run monetary supply."

"Time lags" are, of course, related to "slippages," but a number of other aspects of the problem also have to be pondered. The first, and perhaps the most important, time lag is that between the true beginning of a new cyclical direction and the time when the Federal Reserve System recognizes the new direction. In the Report this is not mentioned, perhaps out of courteous sympathy for the extremely difficult task which the Federal Reserve must constantly undertake in its effort to keep abreast of economic direction changes in their earliest stages. The time lags which are listed[55] are those (1) between the action of the Federal Reserve and the action's influence on the effective money supply, remembering the "slippages," and (2) in the various industries, between the time when credit availability or interest rate changes occur and when they finally begin to have a bearing on production and employment.

As in the case of "slippages," the Staff Report does not appear to regard these phenomena as anything to criticize, but, rather, as facts of life which must be taken into consideration in any evaluation of the merits of general monetary policy. In view of the writers' dim view of these merits, it may be assumed that, without specifically saying so, they regard the slippages and time lags as just two more groups of operational shortcomings in a machine of doubtful utility.

In the Monetary Commission Report, a very brief passage[56] on time lags serves as an introduction to what the Commission regards as an inadequacy--the Federal Reserve's refusal (at least up until February 1961) to admit that it wished to influence the pattern of interest rates:[57] ". . . a more direct and immediate pressure on long rates can be brought to bear by both Treasury and Federal Reserve sales of the long-term securities . . . the effectiveness of monetary policy on the downswing will be increased if the Treasury and the Federal Reserve take direct action to reduce long-term as well as short-term interest rates."

A specific recommendation is made by the Commission: 58/ "Instead of relying on a 'bills-only' policy, the Federal Reserve should be willing, when domestic or international conditions warrant, to influence directly the structure as well as the level of interest rates in pursuit of countercyclical monetary policies and should deal in securities of varied maturities. This recommendation does not mean a return to a pegged structure of prices and yields for government securities. And the normal use of open market operations in bills to carry out technical and seasonal changes in bank reserves is appropriate."

In taking the stand, the Monetary Commission is in line with others who have, over the years, suggested that the System modify its so-called "bills only" or "bills preferably" philosophy. The J.E.C. Staff Report did not give much space to its analysis, but wound up with a firm recommendation: 59/ "The bills-only policy should be abandoned in the interest of eliminating meaningless fluctuations of the prices of Government securities, as well as to increase the effectiveness of monetary policy."

The Joint Economic Committee, in its Report #1, went far beyond anything which its staff had proposed. 60/ "We are advocating that the Federal Reserve System assume responsibility for the orderly behavior of our credit markets." Moving still farther along the same path, and only two paragraphs later: "In 1951, the Federal Reserve held almost $5 billion in long-term bonds which was 21.5 percent of its total portfolio holdings of $22.7 billion. As of the end of October 1959, the Federal Reserve held only $1.5 billion in long-term bonds which was only 5.7 percent of its total portfolio of $26.3 billion. There is no reason why the present ratio should not be improved."

Apparently fascinated by the thought of all those prospective billions of long-term bonds vanishing from the market into the portfolio of the Federal Reserve, the Committee made one more suggestion: 61/ "Another concept is that of expanding the Federal Reserve System portfolio, upon which the fractional reserve system operates, by 3 percent per year. As the Federal Reserve now holds slightly more than $25 billion in Government securities, such an expansion would require the purchase of about $750 million of Government securities in the first year . . . it would appear that the purchase of long-term securities for this purpose would be warranted. This would help to lengthen the debt structure, increase the price of bonds, and have the effect of lowering the long-term interest rate." Adding emphasis to this point, the Joint Economic Committee, in its Report #2, listed as its first major recommendation: 62/ "The Federal Reserve should . . . abandon its discredited 'bills only' policy."

The System may have taken the sting out of these attacks by doing what the critics have been demanding for so long, i.e., dropping the "bills only" policy. Since February 1961, purchases for the portfolio have included a substantial volume of short maturities other than bills, as well as some longer securities. However, no one outside the System knows whether this is a permanent or a temporary practice. Neither does anyone outside know whether or not the System plans to sell part or all of these securities at some point in some cycle. For that matter, no one on the outside knows whether the System has had, or now has, any specific plan or philosophy of any kind for the whole operation.

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As an ambiguity in Federal Reserve use of its tools, the J.E.C. Staff Report mentions the discount rate: 63/ "Sometimes discount-rate changes are apparently meant to serve as signals of the System's intentions, while at other times the rate is changed merely to keep it in alinement with prior changes in market rates of interest. It is not always clear when a change in the rate is meant to be a signal and when it merely represents a passive adjustment to the market."

Two alternatives are proposed by the J.E.C. staff: 64/ "Since 1956 the Bank of Canada has kept its discount rate linked to open market interest rates by setting the rate each week one-quarter percent above the average issue rate at the most recent Treasury bill auction. This arrangement avoids the ambiguities that arise in connection with the interpretation of the significance of discretionary changes in the discount rate and automatically preserves a consistent relationship with other interest rates. It appears to have much to recommend it in the United States. An alternative that might be considered would be to get rid of rediscounting altogether and rely on interbank borrowing to perform the safety valve function now performed by borrowing from the Federal Reserve."

One more suggestion is broached, two pages later: ". . . there seems to be no sensible reason for leaving the initiative with respect to the discount rate in the hands of the individual Reserve banks, assuming that discretionary discount rate changes continue to be employed."

The Joint Economic Committee clearly approved of its staff's work in this area, and spoke strongly on the matter in Committee Report #1. 65/ "Rediscounting should be eliminated as a general practice . . . in the postwar period it has been demonstrated again that rediscount arrangements are a source of trouble. They provide a way by which banks can offset monetary restraint . . . If rediscounting is not eliminated entirely, at least the use of the rediscount rate as an influence on interest rates should be. The rediscount rate should be made a penalty rate, and only adjusted for the purpose of keeping it so."

The Monetary Commission rejects the thought that rediscounting should be eliminated: 66/ "The argument for retaining the privilege is that it provides a smoother means of adjustment to temporary and local situations than would be available otherwise, and that any slippage in the process of general monetary restraint can be easily offset by open market operations."

Meditating on the use of the discount rate, and on the way in which it is set, the Commission finds that: 67/ ". . . because market rates move continuously whereas changes in the discount rate are made infrequently, the relationship between the discount rate and market rates varies. Changes in this differential often have effects that tend to counter those pursued by open market operations." (underlining supplied)

One would think that a comment to the effect that the discount rate had been so used that it often opposed, rather than complemented, open market policy, would lead the Monetary Commission to a strong conclusion, perhaps similar to that of the Joint Economic Committee. This does not happen, though, and the Commission lamely concludes: 68/ "If the Federal Reserve chooses to do so, it can now change the rates weekly, and it can inform the public directly whenever a given change represents a basic shift in policy rather than a technical readjustment. The Commission favors the fully discretionary system and urges that it be administered to avoid effects counter to those sought by open market operations." All that is then added to this hopeful admonition is a suggestion that the discount rate be nationally the same.

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Out of this group of subjects for criticism, it is possible to guess that the Federal Reserve will not experience any severe challenges unless it fails to establish clearly that it has thrown overboard the so-called "Bills Only" philosophy. As to the use of the discount rate, the System will not, it would seem, ever be forced by outside pressures to institute a change--however badly the change might be needed. Political leaders probably will not apply the pressure, because the issue is a "hard" one, rather than an attractive "soft" one. Business, professional, and labor groups, like the Monetary Commission, will not exert severe pressures either, possibly for more or less similar reasons, or perhaps because they hesitate to object to a practice so long sanctioned in the financial folklore.

#6 - THE FEDERAL RESERVE IS UNDULY, AND WRONGLY, INFLUENCED BY PRIVATE BANKING INTERESTS

When an organization has gone through forty-eight years of financial leadership without a hint of scandal, it is surprising to find that a thread of criticism based on suspicion or anticipation of skullduggery should appear. Principal weaver of the thread is Congressman Wright Patman, but he occasionally finds support among other figures on the Hill. The place where the suspicions take their most definite form is in the matter of the way the Board has made use of its power to alter reserve requirements during the last eight years.

The tone which is encountered in this thread of criticism is illustrated in a colloquy between Chairman Patman and a witness, Mr. Robert G. Rouse, of the New York Reserve Bank, at the Hearings before the Joint Economic Committee, June 1, 1961.[69] Mr. Patman is referring to the five presidents of the Reserve Banks who serve as members of the Federal Open Market Committee, as well as to the other seven presidents who sit in the meetings as guests:

> Chairman Patman. . . . the five presidents have more of a private, profitmaking, almost a selfish interest, as compared to the public members. The public is, therefore, required to accept the judgment of people who have an ax to grind . . . I think Congress made a terrible mistake when it allowed representatives of private banks to be on these policy-making boards that fix the interest rates and the supply of money and things like that . . . it (the will of Congress) is disregarded when they bring in all 12 of the presidents, each one of them having an ax to grind . . .

CRITICISM OF THE FEDERAL RESERVE SYSTEM, 1959-'61

A year and a half earlier, in January 1960, Mr. Patman had introduced a bill (H.R. 9511, January 11, 1960) which showed how distrustful he was of Federal Reserve motivations. The bill provided for the transfer to the Secretary of the Treasury of $15 billion of Government securities held by the Federal Reserve Banks, in return for a nontransferable, non-interest-bearing demand note of the United States in the same amount. After going over his reasons for introducing the bill, he said:[70] ". . . the present Federal Reserve authorities have a way of taking the bit into their own teeth and doing what they please to do, notwithstanding laws and expressions of congressional intent. They have come to believe that the Federal Reserve System is a fourth branch of the Government which stands over and above the three constitutional branches of Government . . . they feel that they are not subject to the laws that govern mortal men. So, just in case the Federal Reserve authorities get it into their heads to reduce their holdings of Federal securities despite the recent and clear congressional mandate to the contrary, having $15 billion less of marketable Government debt obligations would make such an idea much less tempting. At least there would be $15 billion less of Government securities which could be given away."

The same attitude is displayed in the keen enjoyment he seems to take in getting officials of the System to deny that the stock of the Federal Reserve Banks is really a stock at all, and to affirm that the Reserve Banks are not, therefore, really owned by their stockholders. Mr. Patman had Mr. Carl Allen, president of the Federal Reserve Bank of

Chicago, on the stand on June 6, 1960, and quoted to him a statement by Mr. Fred Wilson, former assistant vice president of the Chicago Bank, to the effect that Federal Reserve Banks are owned by the member banks:71/

> Mr. Patman. . . . So there is a newspaper quotation from your very first assistant, Mr. Allen, saying that the Federal Reserve Bank is owned lock, stock, and barrel by the member banks. Now you don't agree with that, do you?
>
> Mr. Allen. I do not.

On June 10, Representative Oliver, of the same subcommittee, embarked on a series of similar questions with Mr. Alfred Hayes, president of the Federal Reserve Bank of New York. Oliver quoted72/ several standard economics textbooks, one after another, all stating, of course, that the Federal Reserve System is privately owned by the member banks. In each case Hayes said that he did not agree with the quoted passage, or words to that effect. The series of repudiations ended with:

> Mr. Oliver. Another one . . . is entitled "Money and Banking" by Weldom Wefling, American Institute of Banking, American Bankers Association, published in 1958, and here the statement is categoric: The member banks own the 12 Federal Reserve banks.
>
> Mr. Hayes. That I would disagree with entirely.

It would appear that the general lack of confidence as to motives, which Mr. Patman has expressed so frequently, and in so many different ways, lies behind the criticism leveled at the System for the manner in which it has employed the reserve-requirement tool in carrying out monetary policy during the last eight years.

CRITICISM OF THE FEDERAL RESERVE SYSTEM, 1959-'61

The Federal Reserve System always has a choice of two methods when it wishes to ease or restrain the credit situation, i.e., it can work the desired effects either through the use of open market transactions (ordered by the Open Market Committee) or through altering reserve requirements (ordered by the Board of Governors). Essentially similar end-results are brought about in either case, although endless debates are carried on among economists as to speed of accomplishment, side effects, and so forth. When easing is done through reducing reserve requirements, the commercial banks do not initially sell any securities to the Federal Reserve and so retain earning power from these securities, earning power which would otherwise go to the Federal Reserve and eventually back to the Treasury. On the other hand, when restraint is imposed through raising reserve requirements, the commercial banks do not initially purchase any securities from the Federal Reserve and so do not benefit by obtaining earning power from the securities. Instead, the System continues to enjoy the earning power from the securities.

Obviously, the commercial banks would like for the System to ease by reducing reserve requirements and to firm by engaging in open market selling. Conversely, those who feel that the commercial banks need no largesse of this sort would ordinarily prefer that the System ease by engaging in open market purchasing and firm by raising reserve requirements. Arithmetical illustrations, simplified, will make clear the sort of sums involved.

Assume that it was decided to try to ease by expanding commercial banks' liabilities (deposits) by $6 billion, over a period of several months. If the Board were to order reserve requirements lowered by $1 billion, the commercial banks would presumably then go out and add loans and investments in the amount of about $6 billion, thereby also increasing liabilities (almost entirely in deposits) by the same $6 billion. Assume that it was decided, a year later, to try to impose restraint by contracting commercial banks' liabilities (deposits) by $6 billion, over a period of several months. If the Open Market Committee were to order the sale of $1 billion of securities to the commercial banks, their reserves would be reduced by $1 billion, and they would presumably contract their total of loans and investments by a gross amount of $6 billion, making a net reduction of $5 billion, considering the purchases just made from the Federal Reserve. Back at the same deposit level from which they had started, the commercial banks would have gained by the substitution of $1 billion of Government securities, purchased from the Federal Reserve, for an equal amount of non-interest-bearing reserve balances. This is an attractive sequence of events for commercial bankers.

Reversing the order of use of the two monetary tools, assume that the easing had been carried out through open market operations, the purchase of $1 billion of securities by the Federal Reserve from the commercial banks. The earning power of the $1 billion of securities would, from then on, flow to the Federal Reserve, and thence on to the Treasury, instead of to the former owners, the commercial banks. The banks would presumably go out and add loans and investments in the amount of $6 billion. Deducting the $1 billion of securities previously sold to the Federal Reserve, their portfolio increase would amount to $5 billion, but their total assets would be up $6 billion when their added reserves were included. Their total liabilities (almost entirely in deposits) would have grown by the same $6 billion. Assume that it was decided, a year later, to try to impose restraint by contracting commercial banks' liabilities (deposits) by $6 billion, over a period of several months. If the Federal Reserve Board were to order reserve requirements increased by $1 billion, the commercial banks would presumably contract their total of loans and investments by about $6 billion. Back at the same deposit level from which they had started, the commercial banks would have lost earning assets in the amount of $1 billion of Government securities sold to the Federal Reserve. This reversed sequence of events would not be one to gladden the hearts of commercial bankers.

If both easing and firming were carried on with the same tool--either open market operations or changed reserve requirements--the commercial banks would neither gain nor lose over the cycle in the manner illustrated above.

Anyone who feels that the commercial banks are earning an adequate return on their capital funds would tend, other things being equal, to favor a practice of the System's using open market operations to ease and reserve requirement increases to firm. This sequence brings in some revenue to the Government and takes away some revenue from the commercial banks. Those who feel, on the contrary, that the commercial banks are needful and deserving of special favors would tend, other things being equal, to vote for the practice of using reserve requirement reductions to ease and open market operations to firm. This is what the Federal Reserve has done in recent years, explaining its actions by saying that, in its opinion, 73/ there are certain advantages of diffusion, flexibility, effectiveness, etc. in following the course it has followed. A skeptic who might question these unproven expressions of opinion would find it equally impossible to support his argument with facts. He, too, would have to rely on opinion, and his opinion might be founded on less experience than that of the System's executives.

As one more item of factual information to serve as background for a brief sketch of the critical comments, member bank earning rates in recent years are listed below: 74/

MEMBER BANK EARNINGS

Net after taxes and
after all charges

As a percentage of average total capital accounts, and in millions of dollars

	Percentage on Capital	In millions of dollars
1949	7.6%	686
1950	8.3%	781
1951	7.6%	756
1952	7.9%	829
1953	7.8%	865
1954	9.3%	1,096
1955	7.9%	985
1956	7.7%	1,027
1957	8.3%	1,169
1958	9.7%	1,457
1959	7.9%	1,257
1960	10.0%	1,689

One may start the sketch with the concluding portion of an extended colloquy[75] between Chairman Douglas of the Joint Economic Committee and Chairman Martin of the Board of Governors of the Federal Reserve System, on July 30, 1959, at a hearing before the Joint Economic Committee. The two distinguished gentlemen were not able to get together in the questioning and answering:[76]

> The Chairman. Mr. Martin, to come back to this original point, which I think is very important, if the two methods give the same ultimate result which you admit, but one of them in the process yields a gain to the Federal Reserve and to the Government of an average of $500,000 a year, and added interest earnings which accumulate as

additional amounts, why not take the method which, giving the same ultimate result, yields large capital gains and large increases in net revenue to the Government.

Mr. Martin. Because, Senator, we are not dealing with ultimate results. We are not dealing with a mathematical equation that comes out at a certain point. We are dealing with a flow of money of a continuous nature. It just is not, in my judgment, an easy matter, nor is it correct to say that you can regulate that flow just as effectively by something that will come out with an end result in terms of benefit to the Treasury or benefit to the banks.

Six months later, on February 2, 1960, before the same Committee, the same two had the same difficulty in making any progress toward an area of mutual understanding:77/

The Chairman. Now, is it not true that you can get the same result in expansion of the monetary medium by open market operations as you can by lowering reserve ratios?

Mr. Martin. At a time of recession; no, sir.

The Chairman. But I mean over the long run. In normal periods.

Mr. Martin. Leaving out recession or boom--but that is what we are usually dealing with, one of the two. If you want to put it in long-run mathematical terms, I would say the answer is "yes."

The Chairman. In a normal period?

Mr. Martin. In a normal period. But I merely point out that we have had practically no normal periods.

The Chairman. Well, there must be some normal period.

Mr. Martin. Well, I must say my job would be a lot easier if I could get a few.

The Chairman. It is either abnormal up or abnormal down? There is no abnormal down?

Mr. Martin. That has been the experience. And I think it would be a lot easier for me if we had more normal periods.

The Chairman. Mr. Martin, I want to suggest that I think you are obscuring fundamentally the intellectual issue. Is it not true that you can get substantially the same increase by open market operations, which will increase member bank reserves, as you can by lowering reserve ratios . . . ?

In the J.E.C. Staff Report, it would seem as though the writers had brushed aside the opinions expressed by Federal Reserve spokesmen relative to the advantages of using reduced reserve requirements for easing. The conclusion[78/] is brusque:

> "The use of open market purchases of Government securities to supply reserves to the banking system has an advantage, from the standpoint of the Treasury, over reductions in reserve requirements, since open market purchases absorb securities in the Federal Reserve System's portfolio and since most of the interest on that portfolio is returned to the Treasury at the end of the year. There are, of course, other differences between open market purchases and lowering of reserve requirements. Lower reserve requirements clearly tend to result in larger profits for the commercial banking system. . . . Aside from these factors, it is difficult to see that there are any significant observable differences in the impact of these two credit control weapons. . ."

The members of the Joint Economic Committee followed the lead of their staff, and made this a major issue. In Committee Report #1[79/] they said:

> "The ultimate effect of either weapon is the same. There is very little to choose between them on the final effect which will come about. Furthermore, at best, there are only very minor differences in the effects of the process. . . the Federal Reserve has not raised member bank reserve requirements since 1951 and has lowered them several times, particularly in the two periods of recession since 1953. It appears to be aiming at a general reserve requirement level of about 10 per cent which, in the opinion of this committee, is not necessary nor in the public interest."

As might be expected, Mr. Patman goes far beyond his own majority on this subject:80/

> "It seems to me, however, that the Committee's recommendation does not go far enough. It would not restore to the public the Government securities which the Federal Reserve has given away from the vaults of the Federal Reserve Banks in the course of its successive reductions in reserve requirements since 1951. There should be a restoration of reserve requirements and a return of these assets to the Federal Reserve System."

The issue was kept alive by the Joint Economic Committee in Committee Report #2, in the form of a major recommendation81/that "The Federal Reserve should . . . use open market operations rather than lowering reserve requirements as the means of bringing about the secular expansion of credit which the Federal Reserve and the banks desire."

The Monetary Commission Report is so brief and vague on this controversial question that it is difficult to tell how deeply they considered the problem, or, for that matter, to what conclusion they came. If one were to hazard a guess, based on their three short paragraphs of treatment, it would be that the Monetary Commission was nearer to the

Joint Economic Committee than to the Federal Reserve in its thinking. The conclusion in the Monetary Commission Report:[82]

> "There is little clear evidence to indicate that the effects of open market operations are slower than those following reserve requirement changes. Nor is it clear, in view of the other lags involved in monetary policy, that any difference in timing is large enough to be important.
>
> "The Commission believes that the power to change reserve requirements should be used only sparingly and favors major reliance on the use of open market operations for countercyclical adjustments."

*

The use of reserve requirements could scarcely be envisioned as a problem likely to be very annoying to the Federal Reserve System over the next few years, on straight economic grounds. However, it has obvious appeal for any political leader who wishes to challenge the motivations of the System's officials while, simultaneously, alleging that large sums are being handed to commercial bankers instead of being returned to the Treasury via the Federal Reserve. As the Joint Economic Committee wrote[83] in Report #1:

> "In fact, if instead of the policy of lowering reserve requirements, the expansion of credit which was created by this means since 1953 had instead been created by open-market operations, the net increase of revenue to the Treasury at the bond rate would have amounted to a total of almost $500 million and at a present annual rate of some $112.7 million."

#7 - THE FEDERAL RESERVE PROMOTES HIGH INTEREST RATES, TO MAKE MORE PROFITS FOR LENDERS

A contention of the kind described in the section heading above is quite different from one which says, for example, that the System has been unwise with respect to the influence which it has exercised on interest rates in some cycle. This broad contention is often not based on economic reasoning so much as on political or emotional considerations. It frequently involves, as in the debate on reserve requirements, at least an implied mistrust of the motives of central bank authorities. In some cases, it appears that the critics wish to assume away the free market mechanism and to substitute some sort of Utopian magic for the hard rules of the real world.

There are, no doubt, many times when this essentially noneconomic criticism becomes entangled with economic analysis. The same individual who may be demanding, say, a permanently low, economically impossible interest rate on home mortgages, might also deliver a carefully-reasoned critique of the Federal Reserve's firming steps as taken during the thrust phase of the most recent business cycle. However, the two lines of criticism are ordinarily identifiable as quite different things, and deserve to be looked at separately.

It is important to the Federal Reserve that the two lines be kept separate, because the noneconomic attacks cannot be answered in economic terms. They either must be ignored, or must be answered with arguments which are not founded on the facts of life as known in the world around us. Usually, if an answer were attempted, it would be necessary to try to talk to the point of what could or should be done in a controlled economy from which the free practices of a free people had been removed.

This statement, though, may not be wholly fair to some of the critics in the school which is being labelled here as "noneconomic" or "emotional" or "nonfree enterprise." A critic belonging to the school can insist that these rather disparaging names are not justified, because he is actually trying to restore some freedom to financial markets which he thinks have been twisted out of shape by a central bank devoted to the profitmaking wishes of financial institutions. Undoubtedly, some of the critics truly believe that this is the situation to which they are addressing themselves.

Fortunately for the System, this form of criticism is not encountered too often. Neither does it seem to be well-organized nor well-publicized. Perhaps it is of no real significance, in that it is probably overwhelmingly outweighed by a high public regard for the integrity and patriotism of the men who have managed the Federal Reserve over the years. Quotations from two people, cited below, constitute a warning, though, that it must not be completely neglected.

One of the strongest general statements was made by Congressman Wright Patman, in an Appendix[84/] to Committee Report #1, issued January 26, 1960:

> "On the facts, I cannot avoid the conclusion that the tight-money and high-interest policies have been a principal cause both of increasing prices over the past 7 years as well as a cause of the Nation's substandard rate of economic growth in those years. In other words, these policies do not give us a choice between two evils but an abundance of both evils . . .

"This diversion of income through high interest benefits the few at the expense of the many . . .

". . . Federal Reserve spokesmen have been less than candid with Congress and with the general public, disclaiming at times that they have anything to do with matters about which they have all to do . . .

"The persistent and pronounced bias of the present Federal Reserve authorities has been in favor of the financial elite, in favor of high interest for the sake of high interest, in favor of the banking business it is supposed to regulate . . ."

Professor James Tobin, Sterling Professor of Economics in Yale University, wrote a magazine article[85/] which was published in January 1961, just before he was appointed by President Kennedy to be a member of the Council of Economic Advisers. In the article, he roundly criticized the Federal Reserve on a number of grounds. Some of his sharper remarks were:

"The Federal Reserve has tended to take the view . . . that there is a single correct monetary policy--namely the course which, within the limits of human error, the Fed pursues. Federal Reserve spokesmen contend the inevitable consequence of a deviation from their course of monetary restraint would be an eventual collapse which would more than offset temporary gains in employment and output.

"The economic logic of this prediction is, to say the least, obscure . . . Whatever its logic, it is expounded and believed with ideological fervor inside and outside the Federal Reserve System.

"This conviction may lead the Board of Governors to resist and to frustrate any effort by the Kennedy Administration to gear the federal budget and other instruments of economic policy to higher levels of employment and production."

A few paragraphs further along:

> ". . . 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."

It is obvious that spokesmen for the System cannot reply in kind to attacks of this type, because what would ensue would not be a debate, it would be a name-calling contest. What can be done is to publish studies on such subjects as how the flows of funds in the economy affect interest rates, or compilations of interest rates in other countries, or outlines of the history of interest rates in the United States. Facts and figures will do something toward disproving the hostile allegations.

#8 - THE FEDERAL RESERVE SHORTENS ECONOMIC UPSWINGS AND STUNTS NATIONAL ECONOMIC GROWTH

This is the wrap-up category of critical comment. Those who are sufficiently annoyed with the Federal Reserve System, on enough counts, sum up by claiming that it has stunted cyclical and secular economic growth in the United States. The people who level these grave charges range all the way from fully qualified to completely unqualified. Very often, their motives are showing, and the motives run the gamut from thoroughly patriotic to entirely selfish.

Despite the enormous complexity of the debates which have taken place, and will continue to take place, probably on a much larger scale, the basic issues can be described quite simply. The question is: how should the nation's financial "managers" (insofar as management is possible in a relatively free economy) define the terms, and rate the relative importance of (1) high-level production and employment, (2) an adequate rate of economic growth, and (3) reasonable price stability.

Anyone who is familiar with the attacks of recent years must realize, therefore, that these issues go straight to the heart of the national philosophy. No wonder the discussions sometimes sound as though theological dogma were involved, because the matters being argued back and forth are often just about that important. If it is true, as frequently contended, that decisions have to be made between millions of jobs, on the one hand, and the continued destruction of the savings of millions of savers, on the other hand, then it is hard to visualize a problem more fundamental to the welfare of the American people.

In a debate of this sort, both sides may be expected to hesitate about revealing admiration for either horn of a cruel dilemma. One way to weasel out of such a situation is to deny that there is a dilemma, and perhaps that _is_ true when the issues are phrased in certain ways and definitions are expediently framed. The other way to weasel out is to ignore the dilemma, sometimes even more effective and disarming than to deny its existence. Part of the evasive strategy, in either case, is to shift the attack, or the defense, to some specific practice of monetary management and so focus attention on a detail instead of on the true, big issue.

The quotations to be cited below are not analyzed. They are meant only to show something of the nature of this most comprehensive set of criticisms. They suggest the necessity for a largely expanded, and improved program of explanation on the part of the Federal Reserve.

Aside from Representative Patman, the man who has spoken most often against the Federal Reserve, to the most people, and at the greatest length, must be Mr. Leon H. Keyserling, former Chairman (under President Truman) of the Council of Economic Advisers. His statement[86/] to the Joint Economic Committee, meeting in March 1959, reflects views which he has put forward many times:

> "Monetary policy, in recent years, has been used contrary to all of the three great purposes of our economic life . . . an excessively restrictive monetary policy contributed to a severely contracting rate of economic growth during the period 1955-57 . . . the tight money policy in early 1957 based upon a fundamental misreading of the economic situation, repressed the kind of investment which was already too low, repressed consumption which was already too low, and did nothing to restrain the boom in plant and equipment . . .
>
> ". . . the Federal Reserve System is now again tightening up on money further, when there is still a tremendous slack in the economy; when unemployment is actually rising . . .
>
> ". . . the blunderbuss methods of the Federal Reserve System are again aggravating the distortions in the credit and investment and income structure . . . and again in the overall are repressing production and employment . . ."

The Joint Economic Committee, in its Report #2 (February 1960), said about the same thing, in fewer words:[87/]

> ". . . the monetary authorities have limited their actions almost exclusively to only one aspect of the problem, i.e., stabilizing the price levels, while they have largely ignored the problems of economic growth and excessive unemployment."

Representative Henry S. Reuss, at a Hearing of the Joint Economic Committee held on June 2, 1961, remarked:88/

> ". . . What I am suggesting, Governor, is that the overtightening of credit by the Federal Reserve has contributed to the fact that we have had two recessions in the last 3 years . . .
>
> ". . . Mr. Arthur Burns, who was Chairman of the Council of Economic Advisers under the Eisenhower Administration, in a statement put into the Record . . . said that many factors undoubtedly contributed to the unsatisfactory character of the business cycle expansion from 1958 to 1960, but three of them were preeminent and, as his second cause, he cites the fact that the Federal Reserve pushed its credit tightening with undue vigor."

A little more than a month later, on July 12, 1961, on the floor of the Senate, Senator Paul H. Douglas, former president of the American Economic Association, aired his views:89/

> "The immediate danger is not demand and monetary inflation. Any threatened price increase is more likely to come from administered prices and wages. The basic problem we face is that of idle men and idle capital and a restricted output.
>
> "The choice is therefore squarely up to the Federal Reserve Board. If, as output increases slightly, the Reserve Board again takes fright, as it did in 1958-59, and again restricts the credit supply so as to raise interest rates, it will once more help to choke off a revival and keep unemployment at an unduly high level, as it has done before. I believe the conscience of the country is aroused and cannot again permit the Reserve Board and the financial world to use an abnormally high ratio of unemployment and idle capital as a built-in stabilizer . . .
>
> "The issue is therefore directly up to the Federal Reserve Board and the financial authorities in Government and business. Let us hope that they have the wisdom to act wisely and effectively. May Congress and the public encourage them to realize the gravity of the situation in which we are placed and help them

to cast aside their old errors which have already
cost us so much . . ."

IN SUMMARY

The institutional structure of the American economy in 1961 is one in which, as a result of the increased strength of highly-organized power blocs—labor, industry, agriculture—prices will have a tendency to rise whenever men and machines are operating at anywhere near to capacity. The purchasing power of the dollar is, therefore, subject to possible further deterioration within the next few years. As an important agency especially interested in the integrity of the dollar, the Federal Reserve will find itself again in the unenviable position of having to decide whether or not to restrain what it looks on as "inflationary excesses," at times when its critics may regard the economy's performance as unsatisfactory, and not even near to "inflationary excesses."

If the System continues to act with courage, it will inevitably face a continuing barrage of criticism. The criticisms will be, as in the past, general and specific, fair and unfair, but they may become more powerfully voiced as time goes on. In order to defend itself with sufficient skill and energy to maintain its effectiveness, the Federal Reserve will need to put forth much greater efforts than in the past to gain public support for the policy formulations which will come nearest to meeting all the needs of all the people.

CRITICISM OF THE FEDERAL RESERVE SYSTEM, 1959-'61

FOOTNOTES

1/ Report of the Joint Economic Committee, 86th Congress, 2nd Session, entitled "Employment, Growth, and Price Levels," January 26, 1960, pp. 73-75. Referred to hereafter as "Committee Report #1."

2/ Hearings before the Joint Economic Committee, 86th Congress, 2nd Session, March 20, 23, 24, and 25, 1959; Part 1- "The American Economy: Problems and Prospects"; p. 12 and p. 47. Referred to hereafter as "J.E.C. Hearings, 1959, Pt. 1."

3/ Ibid, P. 165.

4/ Ibid, P. 166.

5/ American Economic Association Handbook, 1956, p. 80.

6/ See note #1, above.

7/ Report of the Joint Economic Committee, 86th Congress, 2nd Session, entitled "Report on the January 1960 Economic Report of the President," February 29, 1960, No. 1152. Referred to hereafter as "Committee Report #2."

8/ "Staff Report on Employment, Growth, and Price Levels," Joint Economic Committee, 86th Congress, 1st Session, December 24, 1959, p. 390. Referred to as "J.E.C. Staff Report" or simply "Staff Report."

9/ Ibid, p. 392.

10/ Ibid, p. 391.

11/ Ibid, pp. 399-400.

12/ "Money and Credit," the Report of the Commission on Money and Credit, 1961, Prentice-Hall, Inc., pp. 75 and 76. Referred to hereafter as the "Monetary Commission Report."

13/ J.E.C. Staff Report, p. 375.

14/ Ibid, p. 368 et seq.

15/ Ibid.

16/ Ibid, p. 372.

17/ Ibid, pp. 396-398.

18/ Ibid, p. 398.

19/ Ibid, pp. 385, 387, 398-399.

20/ Ibid, p. 399.

21/ Committee Report #1, p. 33.

22/ Monetary Commission Report, pp. 73 and 74, the quotation from p. 74.

23/ Committee Report #1, pp. 67-68.

24/ J.E.C. Staff Report, p. 401.

25/ Ibid, p. 365 and, after the three dots, p. 400.

26/ Ibid, p. 400.

27/ Ibid, p. 365.

28/ Ibid, p. 368.

29/ Ibid, pp. 400-401.

30/ Page 32.

31/ J.E.C. Staff Report, p. 378.

32/ Ibid, p. 380.

33/ Ibid, p. 381.

34/ Ibid, pp. 381-383, and p. 393.

35/ Page 65.

36/ Hearings before the Joint Economic Committee, 87th Congress, 1st Session, June 1 and 2, 1961, pp. 82-83. Referred to hereafter as "J.E.C. Hearings, June 1961."

37/ Monetary Commission Report, p. 85.

38/ Ibid, p. 86.

39/ Ibid, pp. 272-273.

40/ Ibid, pp. 276-277.

41/ Ibid, p. 87.

42/ Ibid, p. 90.

43/ Ibid

44/ Ibid, p. 88.

45/ Ibid, p. 87.

46/ Ibid, pp. 85-86.

47/ J.E.C. Staff Report, p. 407.

48/ See note #43. Monetary Commission Report, p. 90.

49/ Ibid, pp. 87-88.

50/ J.E.C. Hearings, June 1961, p. 105.

51/ Monetary Commission Report, pp. 92, 93.

52/ J.E.C. Staff Report, pp. 344-360.

53/ Ibid, p. 359.

54/ Monetary Commission Report, pp. 80-81.

55/ J.E.C. Staff Report, pp. 392-393.

56/ Monetary Commission Report, pp. 56-57.

57/ Ibid, p. 57.

58/ Ibid, p. 64.

59/ J.E.C. Staff Report, p. 426.

60/ Committee Report #1, p. 42.

61/ Ibid, p. 46.

62/ Committee Report #2, p. 16.

63/ J.E.C. Staff Report, p. 405.

64/ Ibid.

65/ Committee Report #1, p. 32.

66/ Monetary Commission Report, pp. 64-65.

67/ Ibid, p. 65.

68/ Ibid.

69/ J.E.C. Hearings, June 1961, pp. 35-36.

70/ Congressional Record, January 11, 1960, p. 229.

71/ Hearings before subcommittee No. 3 of the Committee on Banking and Currency, House of Representatives, 86th Congress, 2nd Session, June 6, 7, 10, 17 and 25, 1960, pp. 18-19.

72/ Ibid, p. 177 et seq.

73/ See the System's memorandum, Hearings before the Joint Economic Committee, 86th Congress, 1st Session, June 24, 27, 28, 29, and 30, 1959, Part 6A, pp. 1462-1465. Referred to hereafter as "J.E.C. Hearings, 1959, Pt. 6A."

74/ Federal Reserve Bulletin, May 1961, p. 521.

75/ J.E.C. Hearings, 1959, pt. 6A, p. 1455 et seq.

76/ Ibid, pp. 1459-1460.

77/ Hearings before the Joint Economic Committee, "January 1960 Economic Report of the President," 86th Congress, 2nd Session, February 1, 2, 3, 4, 5, and 16, 1960, pp. 172 and 173.

78/ J.E.C. Staff Report, pp. 423-424.

79/ Committee Report #1, p. 43.

80/ Ibid, p. 72.

81/ Committee Report #2, p. 16.

82/ Monetary Commission Report, p. 67.

83/ Committee Report #1, p. 44. The supporting table is on p. 45.

84/ Ibid, pp. 63,64,65.

85/ "Challenge," January 1961, p. 24 et seq.

86/ J.E.C. Hearings, 1959, Pt. 1, pp. 102 and 103.

87/ Committee Report #2, p. 3.

88/ J.E.C. Hearings, June 1961, p. 99.

89/ Congressional Record, July 12, 1961, p. 1519.