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~~THE CHAIRMAN OF THE~~
~~COUNCIL OF~~ ECONOMIC ADVISERS
~~WASHINGTON~~

August 31, ~~1969~~ 1968

MEMORANDUM FOR THE PRESIDENT

Subject: The Discount Rate Cut

1. The process of cutting the Federal Reserve discount rate from 5-1/2% to 5-1/4% has finally been completed. On Thursday, the Federal Reserve Board approved reductions by the last four district banks -- New York, San Francisco, St. Louis, and Atlanta.

   - Thus, it took two weeks for the cut to be adopted by all 12 district banks. A delay of this length is unusual, although not unprecedented.

   - Some of the district banks were clearly dragging their heels. Moreover, none of them was prepared to move more than a quarter of a point, even though the Fed Board had invited a decline of half a point.

2. The present attitude of the district banks is worrisome, because the recent discount rate cut was only the first of many steps we will need to ease credit adequately.

   - The discount rate cut has been successful in consolidating most of the decline in interest rates that previously occurred. But it is not acting as a new force to push rates down further. Actually, interest rates have risen a little in the last few weeks -- special, temporary factors have outweighed the Fed's signal of ease.

   - Although homebuilding does appear to be headed upward once again, the strong and prompt recovery we need to sustain the economy is not in the bag, by any means. The 1.5 million rate of housing starts in July looked good. But it was almost surely inflated by a temporary spurt in the Northeast when legal interest rate ceilings were lifted.

3. We believe that further action to ease credit should be taken in September, either

   -- by increased open market purchases to provide more bank reserves, or

   -- by a further cut in the discount rate to 5%.

   We will keep urging the Fed, but we don't know when the message will get through to the district banks.

4. The present problems with the district banks raise anew some old issues about Federal Reserve organization.

   . The Fed's powers to control credit are dispersed in a curious way, with

     -- open market operations controlled by the Open Market Committee (consisting of the 7 Board Members plus 5 district bank presidents),

     -- reserve requirements controlled by the Board, and

     -- the discount rate set by the individual banks subject to "review and determination" by the Board.

   . This arrangement has worked reasonably well in recent years, in part because Bill Martin has an unusual ability to achieve a consensus among often widely disparate views.

   . Nevertheless, desirable action in the national interest may occasionally be thwarted by district bank presidents (or even district bank boards of directors). These officers are not appointed by the President or confirmed by the Senate.

5. Reorganization has often been suggested. It might take various forms, including

   -- elimination of the role of the district banks and vesting all authority in the Federal Reserve Board -- as recommended by the bipartisan Commission on Money and

Credit in 1961 and endorsed by your Task Force on Government Organization chaired by Ben Heineman, or

-- making the heads of the district banks Presidential appointees and eliminating the role of the district bank boards of directors in monetary policy decisions.

We hope you will consider this issue for possible inclusion in January's legislative program.

/S/ Arthur M. Okun