William McChesney Martin, Jr., Papers

Box 20/Folder 9

Series V, Subseries A

Patman Hearings, 1962-1969

List of Proposed Consultants
To Assist with Replies to Questionnaire of (Patman) Subcommittee
on General Credit Control

Stewart, Walter W. Age 66. Retired. Former Director of Board's Division of Research and Statistics; former Economic Adviser to Bank of England; former private investment banker; Professor at Institute for Advanced Study, Princeton, N. J.; Chairman, Rockefeller Foundation; Chairman, General Education Board.

Goldenweiser, E. A. Age 68. Retired. Former Director of Research and Statistics at the Board; Member, Institute for Advanced Study; former President American Economic and American Statistical Associations.

Parry, C. E. Age 68. Retired. Former Director, Board's Division of Security Loans.

Viner, Jacob. Age 59. Professor of Economics, Princeton University and Consultant, U. S. Department of State; former Professor of Economics, University of Chicago; former visiting Professor, London School of Economics and University of Cambridge; former Consulting Expert, U. S. Treasury Department; former President, American Economic Association; Member, Research Advisory Board, Committee for Economic Development.

or

Ellis, Howard S. Age 53. Professor of Economics, University of California; former Assistant Director of Board's Division of Research and Statistics; former Fellow of Social Science Research Council; former President, American Economic Association.

Schultz, Theodore W. Age 50. Professor of Economics and Chairman of Department, University of Chicago, and Economic Consultant to Federal agencies. Chairman, Committee on Agriculture; Social Science Research Council; Director, study personnel in rural social, American Council of Education; former President, American Farm Economics Association.

or

Murray, William G. Age 49. Professor of Economics and Head of Department of Economics and Sociology, Iowa State College; former Economist, Farm Credit Administration; former President, American Farm Economics Association.

Calkins, Robert DeB. Age 49. Vice President, Director General Education Board. Former Professor of Economics and Dean of Business School, Columbia University; Director, New York Federal Reserve Bank; Consultant, National Resources Planning Board and other Federal agencies; Member, Research Advisory Board of Committee for Economic Development.

<u>or</u>

<u>Saulnier</u>, Raymond J. Age 44. Professor of Economics, Columbia University; Director, Financial Research Program, National Bureau of Economic Research; Consultant to Board's Division of Selective Credit Controls.

* * * * *

<u>Wilmerding</u>, Lucius. Age 44. Research Specialist on the structure and organization of Government. Background: 1931-35, Institute of Public Affairs (formerly Bureau of Municipal Research), New York City; 1935-41, Office of Administration Assistance and Bureau of Accounts, U. S. Treasury Department; 1944-48, Institute for Advanced Study. Publication: "The Spending Power" (1943), dealing historically with problem of relation between the Congress and the Executive on expenditures since 1789.

October 3, 1951

Draft - CM:nk 8/20/62

Dear Mr. Patman:

A complete record of all policy actions taken by the Federal Open Market Committee is maintained by the Board of Governors and is set out in full each year in the Board's Annual Report to Congress, in accordance with provisions of the Federal Reserve Act. Included in the report thus made public are: (1) a record, by name, of all votes cast by each member of the Committee in connection with the determination of open-market policies; (2) summaries of the economic and financial developments and conditions taken into account in arriving at policy actions; (3) statements of the reasons underlying the actions of the Committee; and (4) statements of the reasons underlying dissents, when there are dissents.

In addition to this complete record of all policy xx actions, the Board maintains unusually full, detailed, almost vertatim minutes of the discussions and debates of the Committee in executive session prior to final determinations of policy actions. These discussions and debates do not constitute actions and the minutes of them are not, and never have been, made public by the Open Market Committee in accordance with a principle long established and long recognized in the public service -- by the Executive and the Judicial branches of the Government, and by the Committees of Congress as well, including your Committee, in respect to their own operations.

That principle has been stated many times by many eminent Americans whose devotion to the public interest is beyond question.

By a great jurist who served on the United States Supreme Court. Mr. Justice Benjamin Cardozo, in a defense of the privacy required in jury room discussions preceding the recording of jury verdicts -- a defense equally applicable in other areas -- said this: "Freedom of debate might be stifled and independence of thought checked if jurors were made to feel that their arguments and ballots were to be freely published to the world."

By a President of the United States. President Eisenhower, in a letter to then Secretary of Defense Charles E. Wilson on May 17, 1954, in connection with questions raised during the so-called "Army-McCarthy" hearings, said this: "...It is essential to efficient and effective administration that employees (of the Executive Branch) be in a position to be completely candid in advising with each other on official matters, and ..it is not in the public interest that any of their conversations or communications, or any documents or reproductions concerning such advice, be disclosed." And, elaborating at a press conference on July 6, 1955, President Eisenhower added this: "If anybody in an official position of this Government does anything which is an official act, and submits it either in the form of recommendation or anything else, that is properly a matter for investigation if Congress so chooses, provided the national security is not involved. But when it comes to the conversations that take place between any responsible officials and his advisers or exchange of little, mere little slips of this or that, expressing personal opinions on the most confidential basis, those are not subject to investigation by anybody; and if they are, will wreck the Government. There is no business that could be run if there would be exposed every single thought that an adviser might have, because in the process of reaching an agreed position, there are many, many conflicting opinions to be brought together. And if any commander is going to get the free, unprejudiced opinions of his subordinates, he had better protect what they have to say to him on a confidential basis."

Many others, far too numerous for citation here, have held similarly that, and in the absence of anything approaching criminal conduct or malfeasance in office -- and no question as to either can possibly be raised by the minutes of the Open Market Committee -- internal deliberations (intra-organizational advisory opinions, recommendations, tentative plans and proposals, minutes of committee meetings, oral advice, etc.), as distinct from official actions, must, in the public interest, be held confidential for the purpose of encouraging candor on the part of officials and employees in speaking their minds freely and uninhibitedly, and without fear of intimadation by others, then or thereafter.

A wuestion involving the principle thus stated now arises from these circumstances:

On June 14, 1961, by letter, you requested among other things -- all of which were furnished to you -- "the verbatim record of the Open Market Committee meetings, or the full minutes of the Committee meetings, or both, if both verbatim records and minutes were made during the year 1960."

On July 21, 1961, the Federal Open Market Committee in good faith furnished you the full minutes of ~~thx~~ its meetings in 1960, with a covering letter from me that said in pertinent part:

> "Verbatim records of the meetings of the Federal Open Market Committee are not made. The minutes, however, present a faithful and comprehensive record of the Committee's proceedings. The Open Market Committee is prepared to make these minutes of its meetings held in 1960 available to the Joint Economic Committee on the understanding that they will be treated as confidential... With regard to the request that the minutes be handled as confidential, the Committee believes that it would not be in the public interest to have such minutes for 1960 made public in whole or in part at this time, and the reasons for this position are as follows:
>
> "(a) There are references in the minutes to information obtained on a confidential basis. This information, and its sources, should be kept confidential, certainly for a substantial time period.
>
> "(b) From time to time there are references in the minutes to long-term prospects and possible monetary policy actions should these eventuate. To guard against a reduction in the effectiveness of Committee actions or potential actions, there should be some considerable elapse of time before the minutes of any given meeting are given public access.
>
> "(c) The minutes contain a full account of ~~thexjpx~~ the proceedings at the meetings, including the participants' statements. However, a person will frequently compress his remarks by omitting matters of background perspective that are fully understood by others present at the meeting, but which might lead to misinterpretation on the part of one merely reading the minutes without the advantage of having been present.
>
> "(d) The minutes contain statements by individual members which are often made to raise points of discussion or to probe the possibilities of different courses of actions in implementing System policies. These statements do not necessarily represent a firm view of the individual member and, in fact, the member may raise a particular matter merely to obtain discussion and clarification of

the issues involved. Needless to say, individual views expressed early in a meeting may well be modified by subsequent discussions during the meeting. Therefore, the participants should feel free to raise questions and express their views -- either tentative or firm -- with the knowledge that their comments will not be released within a short period of time after the meetings. This freedom of discussion and the exchange of viewpoints prior to the final decision are essential features of the process of decision-making.

"It is largely for the foregoing reasons that the Open Market Committee believes that the public interest would not be served if the minutes for 1960 were to become public documents at this time, either in whole or in part. The Committee is particularly of this view, in the light of the comprehensive record of policy actions made available some months ago in the 47th Annual Report of the Board of Governors of the Federal Reserve System.

"The official records of the Federal Open Market Committee are maintained in the Board's offices, where the original copy of the minutes for 1960 is available for examination by representatives of your Committee. However, with the thought that it would be more convenient, the duplicate original signed copy of the 1960 minutes is being delivered herewith to the custody of your Committee for its perusal. It will be appreciated if this duplicate original is returned to us for safekeeping as soon as it has served its purpose."

Now, under a covering letter dated August 14, 1962, you have furnished us, for the first time, a copy of a 74-page document already in printed page-proof form and inscribed "Joint Committee Print," and you quote a resolution adopted by your Committee to the effect that this print be submitted to the Chairman of the Board of Governors of the Federal Reserve System "with the request that he allow" your Committee "to make it public."

At this first opportunity, the meeting of the Open Market Committee held today, I have placed this matter before the Committee, as I told you I would in my letter of August 16 acknowledging the communication and document received from you, so that you might have a reply as promptly as it is possible to make it.

The time for attention to the document itself has been, as you are aware, severely limited. Even so, it seems clear merely from a single reading that:

1. Not a single action on monetary policy or on operating policies or procedures is shown in your document that was not faithfully recorded in the Annual Report of the Board of Governors for 1960, along with the votes of members of the Open Market Committee thereon, in the economic context of the time, with the underlying reasons for the action stated.

2. Nothing in the slightest way suggestive of criminal conduct or malfeasance in office on the part of any member of the Committee's staff is indicated in your document, as indeed it would have been impossible for that document to indicate in veracity.

3. What is immediately apparent, on the other hand, is that what your letter describes as "a condensed report" by the two economists you assigned to this project describing "issues...and conclusions" at each Open Market Committee meeting "in their own words" does, in true fact, contain scores and scores of selected direct quotations from the minutes, some of them of considerable length, plus selective but extensive accounts of

conversations in literal or lightly paraphrased form, plus some observations, comments and condlusions of the authors themselves.

Thus your document constitutes a form of eavesdropping on internal discussions prior to actions long since made public by the Committee, and what you now propose to do is to give that eavesdropping amplification by the broadcast of universal publication.

That your Committee has the power do so so is unquestioned by us. The question is one you will have to judge for yourselves, according to your own conscience and sense of propriety and of the public interest. The Open Market Committee has neither the means nor the wish to restrict your Committee, and it has never had ~~xxix~~ either; it cannot "allow" or disallow anything your Committee wishes to do.

Yet the Open Market Committee would like to make it clear that, except in making available to your Committee the full minutes of its meetings in 1960, it bears no responsibility for the document you have had prepared, nor would it bear any responsibility for its further publication.

There is no question here of a denial of information to the Congress: your request for opportunity to examine the minutes of the Open Market Committee was granted more than a year ago, and you still have them.

What is in question is whether there shall be broadcast via publication not the actions of a statutory body--which already have been made public, and for which the members of that body now accept and always have accepted total responsibility--but the discussions and debates preceding that action, even though no charge of wrongdoing or of concealment of action, of votes thereon or reasons therefore, has been charged, or would be warranted.

The question has applications affecting the Executive and Judicial branches of the Government, other governmental agencies, and the Committees of Congress, including your Committee, for it is commonplace in all of these to have executive meetings without opening to public gaze the internal discussions, where no wrongdoing has been done or charged.

It seems to us that, to publicize to the world discussions and conversations in any of these meetings -- so long as no wrongdoing is xxx involved--might well raise throughout the Government and the nation, over private meetings and conversations far beyond the confines of the Federal Reserve, a spectre from which American life has hitherto been free -- apprehension that "Big Brother may be watching you" -- and thus do public mischief rather than public good.

The Open Market Committee is absolute in its confidence that it has no cause for shame for anything said at its meetings, and absolute in its recognition that the question of whether your document's selected excerpts therefrom are to be published is solely one for your Committee to judge.

Nevertheless, for the reasons given, the Open Market Committee continues to feel the public interest would be injured rather than helped by broadside publication of the internal discussions preceding its actions. Therefore it repeats this request in its letter of July 21, 1961, transmitting its minutes to your Committee, that you hold their contents in confidence.

Sincerely yours,

ext. 3548

FOR FLAT P.M. RELEASE
Thursday, June 10, 1965
(Speech will be delivered on the Floor, Thursday afternoon, verbatim)

CHAIRMAN PATMAN OF THE HOUSE BANKING AND CURRENCY COMMITTEE CALLS UPON WILLIAM MCCHESNEY MARTIN, CHAIRMAN OF THE FEDERAL RESERVE BOARD, TO EASE HIMSELF OUT OF HIS PRESENT POSITION SO THAT PRESIDENT LYNDON BAINES JOHNSON MAY APPOINT A NEW FEDERAL RESERVE CHAIRMAN SYMPATHETIC TO HIS FISCAL, ECONOMIC AND MONETARY POLICIES; THE TEXAS CONGRESSMAN ALSO ACCENTUATES ECONOMIC ACHIEVEMENTS UNDER PRESIDENT JOHNSON AND CHARGES THAT MARTIN IS "A MAN WHO CAN'T STAND PROSPERITY."

This is the story of a man who can't stand prosperity. Let me modify that statement -- this is the story of a man who can't stand prosperity for the many -- it's A-okay for the few. This is the story of the Federal Reserve Board's Chairman, William McChesney Martin, who believes that it's more important to restrict the money stock and credit of the nation, and increase interest rates, than it is to keep America prosperous. This is the story of a man who is defying the President of the United States by singing a siren song of pending disaster unless we take measures that run counter to the President's, which will in fact insure the reality of that disaster.

An important part of this story has to do with the remarkable advances of the economy under President Kennedy, and continued under Lyndon Baines Johnson. No apology is needed for 52 months of uninterrupted prosperity.

Despite this 52-month record of unprecedented prosperity, the longest peacetime period of well-being in the Nation's history, with 75 million, 100 thousand employed in this country, with our gross national product for the first quarter of 1965 running at an annual rate of $648 billion a year, compared to $622 billion for all of 1964 -- with all of this magnificent achievement rolling along, from out of the woodwork comes the Chairman of the Federal Reserve Board to "CRY HAVOC."

America's Incredible Economic Record Under President Johnson

In the first 50 months of our record-breaking prosperity, our output of goods and services rose by more than $147 billion, an increase of almost 30%. Our growth in the last four years was greater than that of the entire nine years previously. Unemployment fell from 6.8% in the first three months of 1961 to 4.8% in the first three months of 1965. Last week, President Johnson was able to announce that it went down to 4.6% in May, the lowest level since October of 1957.

But, William McChesney Martin of the Federal Reserve Board, in his powerful position, cries havoc -- he can't stand prosperity.

Let's look further at the economic state of affairs under Lyndon Baines Johnson. Inventories remain remarkably low in relation to sales. Price stability is as firm as a weight lifter's muscle. There are no signs of excessive demand or inflationary prices. We are still using only about 89% of our productive capacity and while wages have gone up slightly, unit labor costs are lower today than a year ago, according to the President's chief economic adviser, Gardner Ackley.

The tax cut of 1964 provided a major fiscal stimulus for the economy, and in the offing is the excise tax cut which can only help our economy. Thanks to President Johnson's strong campaign to reduce waste in government, and the increased revenues which continued business expansion has brought, the Administration's budget deficit for this fiscal year will be only about half of last year's deficit. The deficit in our national income budget for the first three months of this year is only $100 million.

For Chairman Martin of the Federal Reserve Board, all this has been too good. He's the man who can't stand prosperity.

Chairman Martin's Open Mouth Policy

In a speech delivered at Columbia University in New York recently, where Chairman Martin noted some similarities between the economic situation now and during the period preceding the Great Depression, he may have unwittingly brought about the beginning of the end of his public career. He frightened the daylights out of not only the stock market community, but business and some important financial circles around the country as well.

I'm inclined to go along with Leon Keyserling, who says that in many respects, Mr. Martin is an "estimable man" and "is not wrong in all respects." Then Mr. Keyserling calls attention to an expansion in consumer debts, which is probably too rapid, that Mr. Martin complains about. But Keyserling notes that Mr. Martin does not tell how the consumer debt situation came about. Mr. Martin carefully avoids mentioning that it is due to a decade under the impact of Federal Reserve Board policies approved by Mr. Martin, which took a heavy toll in unconscionable interest rate rises that are paid by homeowners, farmers, small businessmen, and American families generally.

While Martin noted a few points of vulnerability that need correction in the American economy, he ignored, as economist Leon Keyserling said, the "manifold points of strength that tower above these (points of vulnerability) like Pike's Peak above the plains."

What Martin did was to give some sensation-generating comparisons between the economic situation now and during the late 1920's. He likened some current conditions to those pertaining to the late 1920's, and he played up the idea that now, as just prior to the '29 crash, the clear dangers to our domestic well-being lie chiefly, though not altogether, in our balance of payments difficulties, the monetary policies of France, and our long-standing deficit in international balance of payments.

This is the theory of those who look upon Herbert Hoover as primarily a victim of wicked European forces that brought upon him the Great Depression. This theory is totally discounted by such eminent economic scholars as Senator Paul Douglas, who wrote a study called "Controlling Depressions," and the fine John Galbraith work, "The Great Crash." These economic realists saw clearly that the crash was due primarily to domestic maladjustments, "which caused our productive powers to get more and more out of line with distribution and consumption at home," and which, as I will point out later, were accentuated by the Fed's tight money policies in the late 20's.

Speaking of maladjustments, during the Hoover depression, things got so bad down in East Texas that the folks were forced to go out and catch cottontail rabbits, something we never ate before. They were called "Hoover hogs." If William McChesney Martin keeps up his drive toward disaster, we may call them "Martin hogs."

That the real danger to our economic progress lies in implementing policies that have been discredited because they have time and again brought about man-made depressions and recessions never seems to enter William McChesney Martin's mind. That the very monetary policies which he espouses and puts into practice are what causes national economic distress is totally imperceptible to the thinking mechanism of a man who is so completely Hoover oriented, and who is a believer in the trickle-down money theory. (A prominent Washington writer, who knows him well, told me that he believes that Martin would buy a Hoover collar if the haberdasheries still stocked them.) The cogs in his head click one way -- tight, tight, tight money, high, high, high interest rates; ignore increasing the money stock even when economic activity demands it.

A further note on the Hoover trickle-down policy, which funneled money to the top and mighty little of it to the bottom. There were supposed to be two cars in every garage and two chickens in every pot, according to Hoover. But what the policy really trickled down to was that the car or cars were repossessed by the finance company and there were no chickens, and not even a pot to cook them in. But there were at least two mortgages on all homes that had not been foreclosed.

To return to the matter of money supply, so vital to the economy of every country, let's see how Mr. Martin and the Fed have blundered. In mid-May, our money supply was $159.2 billion. Believe it or not, last December it was a little higher, $159.4

billion. But in the same period, our gross national product increased to where it is now almost $650 billion, and between the fourth quarter of 1964 and the first quarter of 1965, it went up almost $14 billion. I repeat, our money stock remained the same.

The man who can't stand prosperity has not been able to grasp that money supply, credit, and interest rate policies right here at home bring on depressions and recessions. Every single depression and recession that we've had, which put the country through a wringer each time -- three under Eisenhower -- was preceded by a curtailment of the money supply -- a failure to keep the money supply abreast of the expanding economy -- a tightening of credit and an increase in interest rates. This is precisely Martin's policy today -- it was the same yesterday, and the day before, and the day before.

Martin's policy could bring us trouble, but not a depression or a re-do of the horrible Hoover days, because of the great things that have happened under Franklin Roosevelt, Harry Truman, John Kennedy and Lyndon Johnson. I shall only mention a few facts that will show how dissimilar 1929 is from 1965. To those who still get nerve tremors thinking of the Hoover days, let them take courage from the following.

Some Reasons Why 1965 Is Not 1929

In 1929, the government did not have a budget of $100 billion a year. This in itself is a cushion against any major collapse of the total American economy.

During the Hoover depression, the old folks had lost their life savings and had nothing to fall back on. Today, we have the Social Security System which provides some income to 19.9 million of our citizens.

During the Hoover depression, and for the five years preceding it, the farmer had been not a second-class citizen but a fifth-class citizen economically. His income had been shrinking since the mid-20's. Prices of things they had to buy were going up, up, up. Interest rates were also going up, up, up, so that when he went to the bank to borrow money to produce crops or to raise cattle and hogs -- when he wanted to borrow money for any of these things, he was looked upon as a very bad risk and paid through the nose, if he could get any money at all out of his banker.

Today, most farmers are protected by farm programs, and while the farmer's income might not be as high as the farmer would like, he can't conceivably be as bad off as he was when he had nothing but Hoover's famous crack about "prosperity" being "just around the corner" to lean upon.

Mr. Martin, with his Hoover depression mentality, ignores the fact that we have insurance for our unemployed workers. Besides, we have programs that President Johnson is implementing designed to curtail poverty and bring improvement to the worst areas of distress in America, to aid the bottom layer of our wage earners so that the whole economy will not have a continuing drain upon it.

President Johnson is trying to help people to help themselves. Herbert Hoover, best known for his Great Depression, spurred people all along the road to misery. Chairman Martin, the man who can't stand prosperity, appears to want to pick up where Herbert Hoover left off.

Martin Discredits Himself With The Business Community

The business community, the last to turn against Herbert Hoover during his Great Depression -- and what names businessmen called him -- was in sheer panic due to the Hoover Administration mismanagement and lack of foresight in the years preceding the depression and during it -- actually up until Roosevelt's reminder that the only thing Americans "have to fear is fear itself."

I have felt all along that Martin fears prosperity. He is trying to frighten people because we're prosperous. The very businessmen and financial leaders who have supported Martin in his debate with me through the years over the alleged independence of the Federal Reserve System are now beginning to scratch their heads and wonder whether perhaps I haven't been right.

My telephone calls from all over America have been very heavy lately, saying: "What is this 'blank, blank' Martin trying to do?" "Who's back of him?" "What can we do to stop him from ruining our economy?" "Why doesn't he let well enough alone?" "Who's he trying to frighten, a few stock market manipulators or the American people?" "Is it right for an American official to have the authority to make our economy plummet?"

Martin's Policies Must Stop

The really disquieting similarities between our present time and the period immediately preceding the Great Depression is the fact that for the past six months the Federal Reserve has been carrying on a "squeeze it" policy, that is, they have tightened, tightened, tightened credit. That is what happened prior to the Hoover depression.

Besides, interest rates have been going up as they were before the big crash in '29. Bankers then and now were asking big business, small business and consumers to pay more and more for money. While rates today have been going up moderately, except on short-term governments where they have been soaring, if a businessman wants to borrow money for a legitimate project, frequently he is asked to pay "points" to some one in order to obtain the loan. This is a subterfuge employed to collect more than the advertised or announced rate of interest. "Points" are even asked sometimes in order to obtain a home loan.

Another way to increase the interest rate works as follows: The businessman goes to his bank and says he needs a hundred thousand dollars. The banker tells him, "We'll let you have it provided your account never goes below $15 or $30 thousand." This has a nice name -- it is called a "compensating balance." Through this practice, the bank collects interest on a hundred thousand dollar loan, but actually loans the borrower anywhere from $70 to $85 thousand.

Banks are getting bolder and bolder in carrying on this kind of shenanigans. William McChesney Martin is making it easier for them to make these demands on businessmen, large and small, and home owners, and farmers, and laborers, and other consumers -- he is encouraging this type of usury by tightening credit and ever seeking higher interest rates. Have you ever heard of Chairman Martin or any Federal Reserve official protecting the people against injustices caused by extortionate interest rates? The answer is a resounding "No."

Probably the worst practice that's going on in banking is when they find a businessman in distress, they move into his business, in its direction and its ownership. They get their pound of flesh. And the more William McChesney Martin tightens credit and increases interest rates, the more distress there will be in the business community and the more banks will muscle into it, particularly business in distress.

The Fed Is The Root of All Financial Evil

Mr. Martin's Fed has caused every single depression and recession in our time, and always by tightening credit and increasing interest rates, and cutting down on the money supply. For the past six months, the money supply of the nation has failed to increase. It has remained constant. The one way to assure economic trouble is to cut off an orderly increase in money supply necessary for the needs of an expanding economy.

Despite everything that Martin has been doing to curtail our economic progress and well-being, he cannot do away with the mighty pillar of strength erected to avoid disaster to our banking structure. The Federal Deposit Insurance Corporation makes it possible for everyone who has money on deposit in practically all of our commercial banks and savings and loan institutions to know that their accounts are insured up to

$10,000. Last year, I attempted to make the insurance $20,000, but the banking lobby defeated my proposal. William McChesney Martin may do the country wrong economically, but he cannot hurt the basic strength the FDIC represents.

I have enumerated several similarities between what went on in Hoover's day and today, some of them worrisome, that stem from the action of the head of America's central banking system.

Well, you will say, this is another one of Patman's diatribes against William McChesney Martin -- we've been hearing the same for many years. My colleagues, I don't wish to rub it in, but there are none so blind as those who will not see. If you have not had evidence to back up what my contention has been for a long, long time, namely that Martin's tight money and higher interest rate policy, and his mouthings concerning it, are detrimental to the forward movement of the American economy, then Martin's supporters are absolutely right -- Patman is just carrying on a feud without substance.

Businessmen Are Asking Questions

But the American businessmen, both large and small, who call me on the phone today know differently. They ask, "What can you do to shut this fellow up?" "What can you do to counteract the evil that he is doing?" "What can you do to make the

Federal Reserve responsible to the President of the United States?" "What can you do to mesh monetary policy with fiscal and economic policy?" "How can you have the Fed going one way and the government the other and come out whole?" "Must we have two governments in Washington -- one elected and the other carefully selected by a few bankers?"

If you seriously want to know the answers to these questions that have all been asked me in recent days, then I say to you gentlemen, it is high time that we do what I have suggested we do for a long, long time -- bring the money power back to the highest elected officials of the United States government and the Congress. No longer permit the spokesmen for great banking vested interests to govern the direction the American finance and economy should take.

Think hard, think long, my colleagues. I'm not making a plea for a pet peeve of Wright Patman's. I'm talking about the hard core of our economic life, our central banking system. The Federal Reserve is to the American economy what a generator is to a lighting system. If the generator functions properly, light is with us; if it falters, we're in darkness.

The forebodings of depression-minded Martin are those of an unhappy man, whose hand is at the switch of the generator. Or perhaps there is a better analogy. The Chairman of the

Federal Reserve is like the undertaker in the depression days who hadn't had a funeral for six months. He had the longest face in town. There had to be a cadaver somewhere or he would continue in his misery. William McChesney Martin hopes to find the cadaver -- the American economy.

To sum up Mr. Martin's speech at Columbia University in New York takes but a few words -- he came not to praise the economy, but to bury it.

Sir William Petty in 1682 Knew More Than Chairman Martin in 1965

I wish to discuss a bit more about money supply, which is one of the keys to whether American businessmen and consumers have adequate credit for their needs.

In 1682, Sir William Petty, one of the first great economic geniuses to appear, wrote an essay called, "Questions and Answers Concerning Money." In answer to a question, "Is there any way to know how much money is sufficient for any nation?", he answered to the effect that the amount of money has to be in relationship to the national income of a country.

What Petty knew in 1682, Martin hasn't learned to this day. I might add that Sir Samuel Pepys said of this early economist, William Petty: "He was the most rational man who I ever heard speak with a tongue."

Another question in Sir William Petty's essay was, "What remedy is there if we have too little money?" The answer: "We must erect a bank, which well computed, doth almost double the effect of our coined money: and we have in England materials for a bank which shall furnish stock enough to drive the trade of the whole commercial world."

"Mr. Martin as Historian"

In a memorable Washington Post editorial following the Fed Chairman's speech, called "Mr. Martin as Historian," the writer notes that, "Mr. Martin dilated on many of the 'factors that converted a stock exchange crash into the worst depression in our history.' There are many references to collapse of the gold exchange standards, to speculation, to the lopsided distribution of income, and to loose banking practices. But nowhere in his chronicle does the chairman mention the money supply, the central element in any monetary history...What Mr. Martin failed to tell his Columbia audience is that the stock of money declined by a third between 1929 and 1933, and that the Federal Reserve policy was directly responsible for that devastating shrinkage. This point is relevant because the Fed has of late been pursuing a policy of increasing monetary restraint. Their stock of money is now no larger than it was six months ago, and unless it is permitted to grow, the economic expansion will grind to a halt."

"If Mr. Martin's selective history has any moral, it was stated by Santayana who wrote: 'Those who cannot remember the past are condemned to repeat it.' Congress, which under the Constitution is charged with the regulation of the Nation's money supply, can avert a repetition of the baleful past by instructing the Federal Reserve authorities to follow a consistent policy, one that will provide the stock of money required to sustain economic growth."

This editorial is, I believe, accurate in its summation and I shall have it printed in its entirety following my remarks. I wish to point out one fact that the editorial writer omitted, namely, that from early 1928 on, the money stock not only did not grow but actually declined slightly, which played a large part in undermining the economy prior to the 1929 stock market crash.

What the man who can't stand prosperity seems to be doing is emulating the disastrous monetary policy that led to the 1929 crash. This is the most disquieting similarity that can be documented. This is not a myth or a distoriton of maladjustments, 1929 to 1933, vis-a-vis 1965. Mr. Martin's speech makes it clear that he has learned little, that he is prepared to repeat the mistakes of the late 1920's and early 1930's, and of the 1950's. This is truly a disquieting similarity.

Senator John Randolph of Virginia Was a Wise Man

Mr. Martin has been called the king-emperor of America's money system. In other days, the title was bestowed upon such men as Nicholas Biddle, Morgan the First, Morgan the Second, and, of course, Andrew Mellon. Certainly, early in American history, statements and debates over America's money power were as commonplace as they are today.

In 1811, during the debate over the renewal of the charter of the Bank of the United States, Senator John Randolph of Virginia expressed his opposition to the charter. The following statement is attributed to Senator Randolph:

"Charter a bank with $35,000,000 of capital, let it be established and learn its power, and then find, if you can, means to bell the cat. It will be beyond your power, it will overawe your Congress and laugh at your laws."

The particular cat of Randolph's time, symbolizing the aggressive character of the money trust, is still very much alive. I am sorry to say that, to this day, we have not belled the cat. Today its name is the Fed cat. Its immediate parents are the fat cats of the banking community that inhabit an alley of Lower Manhattan Island, known as Wall Street.

In 1818, a committee of the New York State Legislature reported as follows:

"Of all aristocracies, none more completely enslave a people than that of money; no system was ever better devised so perfectly to enslave a community as that of the present mode of conducting bank establishments. Like the siren that entices to destroy.

"They hold the purse strings of society, and by monopolizing the whole of the circulating medium of the country, they form a precarious standard by which all the property of the country -- home, lands, debts and credits, personal and real estate of all descriptions -- are valued, thus rendering the whole community dependent upon them; proscribing every man who dares to expose their unlawful practices."

An Awesome Burden of Responsibility

Such is the power of money power, those who are in controlling position have a responsibility so heavy and awesome that it is almost too much for any man to assume.

One thing about this matter I do know -- certainly the country cannot afford -- even as prosperous as it is -- a man at the helm of our monetary system who is so afraid of prosperity that he has to end it. Certainly, we cannot afford to have a monetary course set one way and a fiscal and economic policy set another. Assuredly, we can't have President Johnson responsible for the well-being of the country and have Chairman Martin, who is not responsible for its well-being, put the brakes on the President's program for economic prosperity.

Eliot Janeway, the noted business economist, stated very clearly the situation when he said, "Any test of Presidential power is bound to be disturbing to business confidence which has come to rest on teamwork between the President, Congress and the executive agencies." And Mr. Janeway noted that the Fed's Chairman, "has created such a disturbance by challenging President Johnson's policy of keeping the banking system supplied with reserves adequate to meet loan demand in an expanding world economy."

Mr. Janeway continues, "The present upset in the stock and money markets recalls the trouble which the Martin administration of the Federal Reserve Board caused during the Eisenhower and Kennedy years. But Johnson is not likely to permit Chairman Martin to involve him in any kind of stock market break or business slump. The prognosis is not for a muddle-along market in Johnson's name but under Martin's management..."

President Johnson Will Not Permit Mismanagement of Our Money System

Knowing President Lyndon Baines Johnson from the time he was 12 years old, having followed his brilliant career, I can assure you that he will not permit the American economy to go to pot.

He will not stand idly by and permit any arrogance on the part of a Federal Reserve Board Chairman, nor will he permit any ineptness to continue for long. Certainly, he will not have the show under his name and somebody else's management.

I have pointed out that the Fed has gone one way and the Administration another, insofar as fiscal, economic and monetary matters are concerned. This is a fact no matter how hard reactionary columnists, who support Martin and the Fed, are attempting to fool the public into believing otherwise.

Would Martin agree with Gardner Ackley, Chairman of the President's Council of Economic Advisers, who said recently: "We saw in the late 1950's what...fiscal and monetary restrictions did to jobs, to profits, to investment and to productivity ...It is in the interest of all of us to avoid falling back into that trap...If we do maintain reasonable stability of costs and prices, we can continue the expansionary monetary and fiscal policies that have contributed so much to our present prosperity."

Or would Martin agree with Secretary of the Treasury Fowler, who said: "To raise interest rates...not only conflicts with our need to maintain our domestic expansion...but would not solve the (balance-of-payments) problem...An interest rate increase large enough to have a significant effect...would almost certainly bring a recession. A recession, in turn, would severely damage the climate for foreign investment in the United States and would also create a strong movement to reduce interest rates immediately."

Mr. Martin would disagree with both of these -- in fact, he did when he said in his Columbia University speech: "Our common goals of maximum production, employment and purchasing power can be realized only if we...prevent orderly expansion from turning into disorderly boom...If an occasion arose when we could preserve the international role of the dollar only at the expense of modifying our favored domestic policies, even then would we need to pay attention to the international repercussions of our actions."

As Frank Porter said, in an astute news analysis in the Washington Post, the Fed Chairman "directly questioned the view of top Administration economists that 1929 is not 1965 and that the present 52-month expansion demonstrates the Nation is capable of sustained economic growth." The very able Mr. Porter pointed out that no matter what the intent, Martin's words have had a "depressing effect." Most objective observers will agree.

Patman's Solution

I believe I have the solution. In view of the fact that Chairman Martin has challenged our President; in view of the fact that the stock market dropped fourteen points in two days following his gratuitous speech; in view of the fact that many business leaders are concerned lest his words cause the end of our 52-month prosperity; in view of the fact that Martin is advocating tight money-high interest rate policies that will bring about the disaster he seems eager to foster -- I suggest that the present Federal Reserve Board Chairman has outlived his usefulness as a public servant in charge of America's central banking system. I suggest that he ease himself out of his present occupation and permit President Johnson to name a Board Chairman of his own choosing.

Many, many times on the Floor of this House, I have pointed out that it is only every four years that a President has the opportunity to name the Board Chairman of our Federal Reserve System, and then he must choose him from the seven Board members holding office. President Kennedy re-appointed Mr. Martin, who had held the office for some time. But my colleagues, do you remember that it was Chairman Martin, re-appointed by President Kennedy, who announced that if he felt it necessary, he would tighten money and raise interest rates if the tax cut suggested by President Kennedy overheated our economic system by permitting people to buy things with the money they didn't have to pay in taxes. He just couldn't stand prosperity for the ordinary American citizen.

It is apparent that the Federal Reserve Board Chairman, no matter who it is, under the existing law has too much power. Last year, the majority of the Domestic Finance Subcommittee of the Banking and Currency Committee, of which I am Chairman, offered some recommendations which would alter the situation that nearly arose when Martin indicated he would, if he felt like it, challenge President Kennedy. Today, the unfortunate situation has actually arisen through the challenge to President Johnson by Mr. Martin.

I not only call upon Mr. Martin to do the decent thing and resign, but I ask that the Congress seriously consider H. R. 11, which was put together after extensive hearings, the most extensive in the 50-year history of the Federal Reserve System. H. R. 11 embodies the recommendations of the Subcommittee and would alter most of the defects that now exist in the Fed. It would no longer permit a Federal Reserve Chairman and his Board to operate monetary policy contrary to the economic and fiscal policies of the President and Congress of the United States. It would make the Fed responsible to the President and Congress, who are elected by the people and who can be removed by the people if their policies do not meet with the people's approval.

Now, Martin and the Fed are responsible only to the banking interests that have been clamoring for tight money and high interest rates.

It is my notion that the American people would prefer to have as head of our central banking system some one who is responsible to them, rather than a man who has been so responsive to the wishes of those who believe in the divine right of money kings.

\- - - - - - -

Chairman Martin

ext. 3548

FOR RELEASE UPON DELIVERY
(Rep. Wright Patman (D.,Tex.)
will deliver speech on the
Floor early Tuesday after-
noon, June 15, 1965)

CHAIRMAN WM. McC. MARTIN IS NOT PRESIDENT LYNDON BAINES JOHNSON

Mr. Speaker, throughout history, there have been men who think of themselves as God. Under no circumstances do I want you to think that I am referring to the Chairman of the Federal Reserve Board, William McChesney Martin. I know that he doesn't think he is God.

Then there are other men like Genghis Khan and Adolph Hitler who thought they were Caesar and set out to conquer the world. I would not put the Chairman of the Federal Reserve Board in this category either.

But there is a man abroad in the land in high position who thinks he is Lyndon Baines Johnson, the President of the United States. He takes the authority that belongs under our Constitution to the President of the United States and delegates it to himself. The Constitution states explicitly that, "The executive power shall be vested in a president of the United States of America," and that, "...he shall take care that the laws be faithfully executed..." The Constitution is again explicit on money power, for it states that, "The Congress shall have power ...to coin money, regulate the value thereof..."

Mr. Martin and his Open Market Committee are determining the interest rates of the country, whether we have adequate credit to meet our needs, and whether our money supply should grow with the economy or fail to do so, as it has in the last six months.

Mr. Martin is not responsible to the people -- he is responsible to the bankers who control the Federal Reserve System.

On the other hand, Lyndon Baines Johnson is responsible to the people of the country, who elected him. By our Constitution, he is duty bound to execute the laws of the land, and the Congress when it set up the Federal Reserve Board had no intention to delegate all of its authority to the Chairman of the Federal Reserve Board.

Mr. Martin ignores this fact. He takes unto himself illegal authority and, as I said the other day, since his policies run counter to that of the President of the United States, who is responsible for the economic and fiscal policies of the country -- the very well-being of the country -- I say to you again, Mr. Martin should do the decent thing and resign. He has no business playing President.

Mr. Martin and his policies run counter to the Employment Act of 1946. The President is responsible for implementing that Act -- "To coordinate and utilize all of the Government's plans, functions and resources...to promote maximum employment, production, and purchasing power."

If you do what the President is attempting to do, you will have prosperity in the country. If you do what Mr. Martin, who thinks he is President, wants done, you will have economic and financial trouble throughout the land.

Again I say, we have no room in this country for a man who holds high office, other than the Presidency, to act as though he were President.

Mr. Martin is obviously not a team man. Again and again and again, I shall ask that he remove himself from high office.

- - - - - - - - -

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

JAMES LOUIS ROBERTSON
MEMBER OF THE BOARD

December 9, 1965

Dear Mr. Patman:

In response to your request that members of the Board of Governors of the Federal Reserve System appear before your Committee on Monday, December 13, I regret to advise you that because of an out-of-town engagement related to the President's Balance of Payments Program, I will be unable to appear on that date.

However, in order to assist as fully as possible in the achievement of your objective of disclosing the factors that entered into the Federal Reserve's recent decision to raise the discount rate and the ceilings on interest rates payable on time deposits, I am enclosing copies of two statements which set forth my own reasons for opposing both actions. The one relating to the discount rate increase was presented to the Board at the time that action was taken. The one opposing higher maximum interest rates was written subsequent to the meeting and submitted for the Board's record. These statements include the main points that I would make orally if it were possible for me to be present Monday.

In the event you wish to make these statements available to members of your Committee, its staff, and other interested people, I am submitting additional copies herewith.

Sincerely,

J L Robertson

Enclosures

The Honorable Wright Patman
Chairman, Joint Economic Committee
Congress of the United States
Washington, D. C.

Statement of Governor Robertson's Reasons for Opposing an Increase in the Discount Rate, December 3, 1965

Changes in monetary policy should not be triggered by fear of prosperity. A prosperous and growing economy has been the goal of public policies, and substantial achievement in that direction in the 1960's should be a cause of gratification rather than concern. It is not inevitable that inflation, boom, and bust must follow from the kind of prosperous performance the United States economy has been giving, and consequently there are no valid grounds for arguing that tightening now is needed to forestall inflationary developments that are sure to come later.

This is not to deny the need for very careful scrutiny of the progress of economic events and a willingness to act to further restrain credit if and as excessive demand pressures actually emerge. I conceive of the present as a time of delicate balance in the economy. Supply and demand forces seem so tentatively poised that abrupt action to change monetary conditions could tip the scales significantly - towards inflation if policy was actively eased, or on the other hand, towards recession if credit availability were sharply tightened.

Financial markets have only recently calmed somewhat after being buffeted by rumors of an impending discount rate change. Such a rate increase now would come as a distinct surprise, with reactions aggravated by the impending seasonal peak of money market pressures. Such action would insure undoubtedly that the heavy volume of Treasury cash borrowing to be done in January would have to be undertaken at substantially higher interest costs to the government.

If, for whatever reasons, a tightening action is to be initiated, it would be far preferable to use a subtle rather than a slam-bang method. An appropriately mild and indirect line of action might be to (1) dampen bank issuance of promissory notes by defining them as deposits; (2) hold Regulation Q ceilings on time deposit interest rates at existing levels for the time being; and (3) take no action on the discount rate, expecting that banks would undoubtedly have to cover some portion of their net December loss of CD's by substantial temporary resort to the discount window. This combination of steps should serve to moderate somewhat the rate of advance in bank credit, while not triggering immediate expectations of higher interest rates in the market and yet, at the same time, placing banks in a position of dependence on the discount window that could lead fairly naturally to a more overt tightening of monetary policy should inflationary developments begin to appear.

Whether or not a breakout of inflationary pressures will in fact occur cannot now be predicted. Accordingly, the best practical course is to adopt a policy of "watchful waiting", meanwhile continuing to supply a reasonable flow of reserves to finance much-needed economic growth. Despite large and sustained expansion since the last recession in 1961, a small but significant margin of human and real capital resources remains unutilized in this country. Further orderly expansion in aggregate demand can effectively employ some of these resources. The accompanying growth in credit and money during this period has been orderly, and has contributed to overall economic growth. Continued orderly credit expansion is needed if our economy is to move on up to the goal of sustainable full employment of available resources.

The price pressures to date from this economic growth have been small and selective, stemming mostly from worldwide shortages of particular nonferrous metals, temporary scarcities of certain agricultural products, and market-testing mark-ups in a few administered-price industries. These are not the types of price increases appropriately dealt with by a dampening of aggregate domestic demand. The temporary nature of some of the recent increases is indicated by the fact that the rate of rise in the wholesale price index has already slowed since mid-year from an annual rate of 2 per cent to 1 per cent. Meanwhile, recent successful Administration actions against aluminum and copper prices reduce the likelihood of other administered-price increases.

The U. S. balance of payments performance does not now supply reasonable grounds for further monetary tightening. The chief burden for further improvement in the balance falls on other policies. The allegedly interest-sensitive components are already performing very well under the discipline of the Voluntary Foreign Credit Restraint program. I see no sign that this program is weakening in so far as its influence on financial institutions is concerned. Corporate direct investment abroad, the category of capital flow that has been least reduced to date, is notoriously insensitive to changing general credit conditions in the United States.

U. S. interest rates are already high by historical standards, and I believe they are generating all the credit restraint that ought to be attempted in the current delicate situation. The federal fiscal position will be shifting to a somewhat less stimulative policy for a time after the turn of the year, and we should be wary of imposing a coincident restraining influence from additional monetary tightening at this juncture. The appropriate monetary policy for later in 1966 can be best judged after we have the benefit of the official federal budget message in January and see the public reaction thereto.

Statement of Governor Robertson's Reasons for Opposing an Increase of the Ceilings on Interest Rates Payable on Time Deposits from 4 and 4-1/2 per cent to 5-1/2 per cent, December 3, 1965

Governor Robertson dissented from this action generally for the same reasons given for his dissent from the action to raise the discount rate. The latter action, he assumed, was designed to tighten credit, in view of the rapid expansion of bank credit; it surely was not designed simply to raise interest rates. However, in his view, the raising of the ceilings on interest rates payable on time deposits would - in virtually the same breath - enable banks to acquire more funds to expand their lending but at higher rates, and thus not serve to reduce bank credit expansion - if that were the aim. In addition, he felt, the larger banks would be able to attract funds away from smaller financial institutions which did not actively engage in the issuance of time deposits but relied on inflows of savings and demand deposits with which to meet loan demands, or, alternatively, to force those smaller banks to also engage in the risky business of competitively bidding for highly interest-sensitive short-term funds with which to make long-term loans.

JOINT ECONOMIC COMMITTEE

OPENING STATEMENT BY
WRIGHT PATMAN, CHAIRMAN
Monday, December 13, 1965

HEARINGS ON THE FEDERAL RESERVE

This hearing is called under Section 5 of the Employment Act of 1946 which assigns to this Committee the responsibility of studying means to coordinate programs to carry out the purposes of the Act.

We have witnessed a most serious lack of coordination that runs to the very heart of that law. I refer to the recent action by the Federal Reserve Board to raise discount rates from 4% to 4½% and to lift the ceiling on time deposits from 4½% to 5½%. The discount rise is 12½%, and the time deposit rate has gone up 22.2%.

There is an old Navy saying that the quickest way to sink a ship is to have two Captains. I believe this applies even more pronouncedly to our national economy. A cartoon from the Washington Post of December 8 showing the Administration and the Federal Reserve trying to pedal one bicycle in opposite directions is a most expressive and accurate description of what is going on.

The Employment Act specifically requires coordination when in Section 2 it charges the Federal Government ". . . to coordinate and utilize all its plans, functions and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities including self-employment for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power."

Further, Section 3 of the Act requires that the President of the United States conduct "a review of the economic program of the Federal Government and the review of economic conditions affecting employment in the United States . . . and the effect upon employment, production, and purchasing power" and to transmit his recommendations annually to the Congress. It also requires that he submit each year a program for carrying out the policies of the Act.

The Employment Act is very clear and specific on the requirement that economic policies must be coordinated and it charges the President, the Congress, and all other officials with this duty. Although no agency was exempted, time and time again the Federal Reserve has chosen to ignore this public law and to go off on its own. It chooses to conduct the monetary policy machinery of this nation as a completely independent and separate operation -- separate from the President, the Congress, and even the law.

Marriner Eccles, a former Board Chairman, had something to say about the role of a Federal Reserve Chairman. I would like to read his statement into the record at this time. It was made before the Joint Economic Committee on August 15, 1961:

> "I think, as a practical matter, it is reasonable to allow the President to remove a Governor when he sees fit. An Administration is charged with the economic and social problems of the Nation. It seems to me to be extremely difficult for an Administration to deal with these problems, economic and social of the entire country, without having these powers. There must be a liaison, a responsive relationship between the Administration and the monetary system. This does not mean political control in the undesirable sense which it is often implied. I think that the Governor of the Federal Reserve Board is the channel through which the relationship with the Federal Reserve System should develop."

A brief review of events of recent weeks provides the needed background for this inquiry into the breakdown of economic policy coordination called for by the Employment Act. On December 1st, the President assured a group of business leaders in Washington that an outbreak of inflation was not anticipated in 1966 and that it would be a record year. He indicated that the 1.8% rise in consumer prices over the past 12 months had been due in large measure to rising food prices. He indicated that this situation had stabilized and was not expected to continue in 1966.

Shortly thereafter the Secretary of Labor told the AFL-CIO Convention that the level of unemployment was still high and that this economy is still not operating at a level necessary to make full use of available manpower. He said "the worst mistake today would be to put on some brakes." The Secretary of the Treasury said recently in New Orleans that the Administration was opposed to any interest rate rise or credit tightening, and that such action would be premature and unwise.

Shortly after these very clear indications of Administration policy the Federal Reserve Board met on December 3rd and decided to change monetary policy without waiting for full development of the Administration's program. The Board voted 4 to 3 to tighten money at once. The facts are obvious. While the rest of the Executive branch of government were coordinating their activities and plans preparatory to submitting them to Congress in accord with the law, the Federal Reserve, under the chairmanship and leadership of Mr. Martin, by their action declared their independence of any coordinating effort.

No other conclusion can be drawn. On December 7th, one day after the Federal Reserve decision was announced, Vice President Humphrey found it necessary to declare that the government policies, which had been coordinated for 57 months, were no longer coordinated as a result of the Federal Reserve increase in the discount rate. The Vice President specifically mentioned that the Federal Reserve did not give full consideration to the Administration proposed budget in making its decision. The Vice President went on to say that "part of the task will be to develop an appropriate fiscal-monetary policy in light of the Federal Reserve action."

The Federal Reserve action poses several serious issues:

1. What is the meaning of these two changes? What do they indicate concerning trends in monetary policy as executed in recent months by the Federal Reserve and as they are likely to execute it in the months ahead?

2. What is the legal basis for this action and is it within the constitutional guidelines as to the authority of the Federal Reserve?

3. Does the current and prospective economic situation justify a shift in monetary and fiscal policies; particularly are there present, or immediate prospective, dangers of inflation such as call for a more restrictive set of government policies?

4. What is likely to be the effect of the Federal Reserve actions on the economy?

5. Was there appropriate coordination with the President, his Advisers, and the Congress concerning the mix of economic policies as called for by Section 2 of the Employment Act of 1946, and which this Committee is directed to study by Section 5(b)(2) of the same statute?

The legal issues are clearly matters for the legislative committees of the House and Senate to consider. The economic questions cannot be answered fully until the President completes his budget and economic program and submits them to the Congress in January. We can, however, reasonably demand a full and frank answer now to the last and most important question: was there proper coordination of economic policies, and if not, why not.

We are glad to hear your response.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 25, 1966

To Chairman Martin

Subject:

From J. H. Furth

Attached a preliminary draft for a speech on Limits of Monetary Policy. It is the revised version of a pre-preliminary draft that has been (rather hastily) scrutinized (and mercifully cut by 40 per cent) by Ralph Young and Bob Solomon. Nobody else has seen it.

If you think that the draft roughly reflects your ideas on the subject and that its line of reasoning sounds convincing, I shall submit the draft, as usual, for comments and suggestions to Charlie Molony, Bob Cardon, Bob Holland, Al Koch, and Art Hersey (both Ralph Young and Bob Solomon will be away this week). I shall also have all factual statements and especially all figures carefully checked and brought up to date.

Unless you advise me to the contrary, I shall assume that you will inform the Treasury or any other Government agency only when the draft reaches a more advanced stage.

Unfortunately, the questions of price and cost developments, vital as they are, may well (at least for the moment) be eclipsed by even more vital and more difficult problems of international finance--unless the disruptive trends of the last few weeks are stopped. The apparent lack of U.S. leadership in this field, compounded by the weakness of the British Government and the dogmatic prejudices and rigidities of the Continental European authorities, has caused anguish even to those of us who so far have managed to retain their optimism and their faith in the good sense of the international financial community.

We all hope and wish for your speediest recovery--and not for personal reasons alone.

JHF

DRAFT:JHF:dch
July 22, 1966

Limits of Monetary Policy

The past nine months have, for the first time since the start of the present upswing 5-1/2 years ago, seen the emergence of serious inflationary pressures in our economy. Wholesale and consumer prices have been rising at annual rates of about 3 per cent; labor costs in manufacturing have begun to inch up; and our foreign trade surplus--our brightest hope in our struggle to end our persistent large payments deficit--has seriously declined.

These developments, while disappointing, have been neither surprising nor inexplicable. On the contrary, they are the normal concomitants of the stage of the business cycle our economy has reached.

Until about nine months ago, we had been able to meet the requirements of a rapidly expanding economy by drawing on unemployed manpower and under-utilized plant capacity. Bringing these idle resources into the production process made it possible to follow stimulative monetary and fiscal policies without bringing forth serious scarcities or bottlenecks of productive factors, which would have strained the maintenance of reasonable price and cost stability and would have impeded progress toward correction of our payments deficit.

All this changed when our economy, in the last quarter of 1965, reached what may be considered a reasonably full utilization of its resources. From then on, further expansion in the aggregate demand for goods and services in excess of the rate of additions to labor force and plant capacity or of a rise in productivity would either be satisfied by means of an increase in imports or a diversion of exports to domestic consumption; or it would be frustrated and result only in rising prices. Clearly, the previous rate of expansion of demand could not be expected to remain sustainable under these changed conditions. Thus, an annual rate of increase of about 6 per cent in the "real" gross national product would have to be reduced to, say, 4 or 5 per cent, in any event; if our GNP as measured in current dollars were to rise faster, it would only lead to serious price and cost pressures and adverse effects on our international payments position.

In order to achieve the transition to a less rapid increase in our national product without risking dislocations that might result in recession or stagnation, it would be necessary for investors and consumers--including, to the extent consistent with national interests, the public authorities--to change their plans. And in order to induce consumers and businesses to do so, it would be necessary to slow down the rate at which additional credit funds, especially bank credit funds, could be made available to potential borrowers, as well as the rate at which consumers and producers would receive further increases in their monetary after-tax income. But as long as the flow of money income and credit is growing as rapidly as hitherto, we cannot expect either consumers to abstain from further increasing their demand for goods and services at the accustomed rate, or producers to abstain from further trying to expand their production facilities at a rate at least sufficient to meet their expectations of future demands for their products.

In fact, the unusually high rate of utilization of plant capacity has induced producers to raise their sights for further expansion over and above the level of previous investment plans, which had been limited by the opportunities for better use of existing underutilized facilities. In consequence, business investment has risen even faster than consumption: between 1964 and the first quarter of 1966, the ratio of private consumption to GNP declined fractionally but the ratio of nonresidential fixed investment to GNP increased from 9-1/2 per cent to 10-1/2 per cent.

Hence, just as the previous state of our economy required a stimulus from both the fiscal and the monetary policy side, the state of our economy since the fall of 1965 has, in my judgment, required restraint, again from both fiscal and monetary policies.

The Federal Reserve System has accepted the policy implications of that analysis. As you know, the discount rate was raised by 1/2 of 1 per cent last December, and the net reserve position of member banks was gradually tightened until these banks had, as a whole, net borrowed reserves averaging about $400 million. Our discount rate now is higher than at any time since 1929, and the new borrowed reserves of member banks are now higher than at any time since 1959.

And, as you also know, this tightening has not failed to exert its influence on the financial markets. The availability of credit for many purposes has been restrained, in the face of surplus demands for funds. In consequence, interest rates have risen sharply. Between September 1965 and July 1966, yields of Treasury bills and medium-term Government securities rose by about 3/4 of 1 per cent and the yield of long-term securities by about 1/2 of 1 per cent; the yields on shares and mortgages rose somewhat less but some bank lending rates, as well as the rates paid by banks on time deposits and especially on the so-called certificates of deposit, rose even more. In order to avert disruption in financial markets from a massive outflow of time deposits from banks, the Board raised last December the maximum rate payable on time deposits from 4 and 4-1/2 to 5-1/2 per cent, and city banks especially have felt compelled to push their deposit rates up to the permitted maximum. In order to stem the resulting shift of funds from other savings institutions to commercial banks, the Board recently raised reserve requirements on time deposits from 4 to 5 per cent--the first increase in reserve requirements since 1951--and also limited rates payable on multiple maturity time deposits.

The rise in interest rates, and the reactions that rise has produced in some quarters, might give the impression that our measures have starved the economy of liquidity. Actually, the opposite is true: the supply of money and credit has continued to expand rapidly--somewhat less rapidly than before, and far less rapidly than it would have in the absence of our action, but apparently still too rapidly for the preservation of price and cost stability and for the improvement, or even for the avoidance of renewed deterioration, of our payments balance.

Again, this result is neither surprising nor mysterious. Once prices generally begin to rise, borrowers quite rightly tend to discount nominal interest rates by the expected rate of the increase in relevant prices. Even though interest rates in money, credit, and capital markets have, over the past nine months, advanced considerably, the rise has been very small if discounted by the increase in prices. And it should occasion no astonishment to find that the movement has therefore been insufficient to induce consumers to increase their savings rate or to induce business to reduce its investment plans as much and as rapidly as would have been necessary to maintain equilibrium between investment demands and flow of savings.

Under these circumstances, two interrelated questions arise: could a more drastic tightening of monetary policy in itself be expected to produce the necessary adjustments unaided by fiscal policy; and if not, does this failure indicate that monetary policy is an inefficient tool with which to maintain or restore financial stability?

Both questions should, in my judgment, be answered in the negative. Monetary policy is a useful tool to counteract moderate deviations from equilibrium; and it is an indispensable tool to assist fiscal and other policies in efforts to remedy a serious disequilibrium; but its use cannot suffice, at least in our own economy, to correct a serious disequilibrium alone and unaided.

Once deflationary or inflationary processes have gathered considerable momentum, quite substantial changes in borrowing plans of producers and consumers are needed to restore equilibrium. In the case of a serious recession, the shortcomings of monetary policy, if unaided by other policies, in trying to generate such substantial changes are generally recognized. But similar limitations also apply to the case of serious inflation.

When everybody expects prices to rise, an increase in interest rates, in order to have a sufficiently restrictive effect, may well need to be greater than the expected price advance. Hence, if everybody expected prices to advance, say, by 3 per cent a year, interest rates might well need to rise by more than 3 percentage points.

But what would happen if the Federal Reserve pursued policies that would rapidly raise interest rates by more than 3 per cent? Would not such a policy be effective?

In fact, it might well be; but it is more likely that it would have unwanted side-effects which would either impair its effectiveness or, even worse, render the action so effective that the boom would turn into a recession.

Let me explain what I mean by this statement.

An action of the Federal Reserve to tighten monetary policy in such a way that interest rates would rapidly rise by more than 3 percent would certainly be considered as signaling a severe financial crisis.

The shock effect of such a signal might be sobering--in fact so sobering that a great many producers and consumers would immediately reduce their borrowing plans. This would mean a very rapid change in the business situation: the boom would be followed, not be a flattening out of the expansion but by an abrupt contraction. Obviously, such a sequence of events must be avoided.

But this would not be the only risk. In fact, the shock effect might have exactly the opposite consequences. Producers and consumers might become convinced that the rate of inflation was in danger of greatly accelerating if the Federal Reserve felt it necessary to permit such a drastic increase in the bill rate. Instead of reducing their borrowing plans, they might, under these circumstances, actually increase them, thus accelerating instead of slowing down the pace of inflation.

There is no way of reliably predicting the effect of such a psychological shock--not only on potential borrowers but also on the political and institutional framework of our credit system, and on international markets. We must never forget that the international implications of our monetary policy are incomparably more important than those of the monetary policy of any other nation: not only because of our leading role in international trade and even more so in international finance; but primarily because of the widespread use of the dollar as an international currency and as part of the monetary reserves of foreign countries. This consideration alone is a good reason for avoiding drastic experiments.

But let us assume, for argument's sake, that the action of the Federal Reserve would have no untoward psychological, political, institutional, or international consequences. What about its probable impact on our domestic economy?

Moderate changes in monetary policy are unlikely to have serious effects on income distribution. The time has past when only the rich man was a lender and only the poor man a borrower. But potentially serious effects might well appear once the changes ceased to be moderate.

A sharp rise in interest rates has a particularly strong impact on certain sectors of the economy, including residential construction, public utilities, and local authority spending for such vital projects as schools, hospitals, and roads. Manufacturing industries, requiring large inventories, would be more deeply affected than service industries without inventories. The budget of the Federal Government, the largest single debtor of them all, may find its debt service increased by more than its additional revenues. And our balance of international payments would be burdened by the increase in interest payments on nearly $26 billion of fixed-interest dollar liabilities to foreigners.

Moreover, our savings institutions might find themselves in difficulties. Even at present rates, savings institutions feel, in some cases, compelled to pay rates on their deposits that are as high as the yield of previously granted long-term credits, such as mortgages. A further drastic rise in rates might compel them to pay rates in excess of such receipts; or else risk withdrawals of funds. Both alternatives might well lead to disturbing, even disruptive developments: the liabilities of savings institutions are relatively short-term--seldom in excess of one year's maturity--, but their assets may have average maturities as long as 10 years. Hence, their assets cannot easily be liquidated to meet sudden large withdrawals of deposits, and their average credit rates change far more slowly than their average debit rates. Neither the Treasury nor the Federal Reserve could idly stand by while savings institutions go down merely as the consequence of a change in monetary policy. Hence, they would be forced to cooperate in rescue operations. At best, this would mean the lending of substantial new funds to those institutions and their depositors or shareholders. Such operations would avert catastrophe but the injection of newly created funds into the economy would be contrary to the objectives of counterinflationary monetary policy.

Even among enterprises in the same economic sector, serious inequities might arise. Small business would probably have greater difficulties in receiving credit accommodation than large enterprises. And newcomers would have greater difficulties than their old-established competitors, even though the new firms might be more inclined toward technological and managerial innovations. Such a consequence would be particularly serious for our economy which can remain prosperous only as long as it retains its leadership in technology and management.

Consumer credit, little affected by moderate changes in interest rates, also would begin to feel the pinch. Purchase of houses, of cars, and of home appliances might become the privilege of those consumers whose income is high enough to make them independent of credit. In the long run, a gradual reduction in the rate of increase in consumer credit might not be bad for our economy; but an abrupt contraction of consumer lending would be serious for consumers and producers alike.

Sledgehammer action would have equally unfavorable consequences for the Government securities market. The Federal Reserve must not go so far in facilitating effective debt management as to override the interests of the economy as a whole, whenever these interests demand tighter credit conditions. But neither must the Federal Reserve make it impossible for the Treasury to finance Government operations. The Federal Reserve must not arrogate for itself a veto power over expenditures authorized by the Congress even though these expenditures may exceed Government receipts and therefore require new borrowing.

Moreover, even when budget expenditures are fully covered by receipts, the Treasury must have continual access to the credit market in order to turn over its maturing debt. Hence, monetary policy must never imperil the success of Treasury financing operations at the current market rate.

The words "at the current market rate" should be stressed: the Federal Reserve must not peg the price or limit the yield of Government securities. Moderate fluctuations in prices and yields of these securities are essential for the smooth working of our financial markets. But excessively large or violent fluctuations would make the markets disorderly. Under our system, monetary policy is, as you know, primarily conducted by means of operations in the open market, and therefore presupposes the existence of a wide, broad, and resilient market for Government securities. Disorderly markets would make the flexible functioning of our monetary policy itself impossible.

Finally, a drastic change in interest rate levels could produce disturbing price changes throughout our capital-based economy. Interest rates determine the present capital value of future income flows. Hence, a rapid and large decline in interest rates would mean a rapid and large decline in the present value of capital, including not only securities but also plant equipment and real estate. Such a general decline in prices could exert a sharp deflationary influence on the plans of consumers and producers. In this way, an excessive firming of monetary policy would again threaten to bring about a serious downturn of the economy rather than the desired transition from unsustailable boom to sustainable growth rates.

All these considerations do not mean that monetary policy is a tool for fair weather only. While it is not a sufficient means to stem a serious inflation, it is a necessary means to supplement fiscal and other policies to that end.

Restrictive fiscal policies--let us say, an increase in tax rates--would fail in their purpose of ending inflationary pressures if the Federal Reserve were to supply the market freely with the funds needed to pay the increased taxes. The tax increase still would exert some effect, since the taxpayers, while maintaining their liquidity position, would be able to do so only at the price of reducing their net assets. But the tax increase becomes far more effective, and especially its impact on investment decisions much greater, when the increased tax payments press immediately--either fully or at least in part--on the taxpayers' liquidity as well as on their income, instead of being financed by additional borrowing.

Moreover, monetary policy has, as you know, the great advantage of flexibility. Under our Constitution, the power to change tax rates is a jealously guarded prerogative of the Congress; and while it might be desirable for Congress under special circumstances to grant the Executive branch some leeway, it is understandable that Congress has been reluctant to do so. But monetary policy can easily and efficiently be used to modify the severity of the impact of fixed tax rates on the liquidity of the banking system and of the economy in general in line with changes in economic conditions, until these changes are large enough to warrant--and necessitate--further Congressional action.

Finally, the limitations on the effectiveness of monetary policy do not mean that the Federal Reserve would be justified in refusing to take anti-inflationary action in the absence of firming fiscal action. Here as so often, half a loaf is better than none: inflation certainly would have progressed much faster over these past nine months if the Federal Reserve had not firmed its policies.

And in view of the understandable tendency of my audience to see forecasts in anything I say, let me warn you that nothing I say should be interpreted as indicating that the Federal Reserve had reached the end of its rope or that any further firming of its monetary policy would be inadvisable or impossible. But it is my conviction that beyond a certain limit--which we may or may not have reached--further firming of monetary policy alone tends to become less effective than an appropriate combination of monetary and fiscal measures.

Until recently, the interplay of our fiscal and monetary policies has been working remarkably well. We can all take pride in the achievements of the past 5-1/2 years: an unprecedented upswing, accompanied until recently by only minimal increases in prices and virtually no increase in labor cost per unit, and by a gradual improvement in our payments balance. This improvement was by no means as rapid and as complete as we should have wished; nevertheless, since rapid economic progress often tends to raise imports more than exports, it might be considered quite an achievement to have brought about a substantial reduction in our payments deficit at all.

But today we are in grave danger of losing the gains we have made. Inflation is harmful everywhere and under all conditions; but it is particularly harmful here and now. If we lived in a closed domestic economy, or if we were in a comfortable balance-of-payments position, we might for a time tolerate without great harm an annual increase in prices at an annual rate, say, of 3 per cent--most if not all our friends in Europe have experienced greater price increases over the past few years. But we are living in an open economy, in which the United States is called upon to play a leading role in international commerce and even more so in international finance, and our international accounts have remained in substantial deficit for nearly nine years.

The entire fabric of the international payments system, on which the prosperity of all trading nations of the free world depends, is based on the universal use and acceptability of the dollar. The stability of most other currencies is of importance mainly to their countries of issue since their currencies circulate only at home. The stability of the dollar is of importance to the entire free world since it is used and held virtually everywhere by merchants, investors, bankers, and central banks. Our international payments system cannot be maintained without a stable dollar; a stable dollar cannot be maintained unless we correct our payments imbalance; and we cannot do so if we succumb to inflation, even to a degree perhaps tolerable in countries that do not have the responsibilities of an international reserve center, and whose international accounts are in surplus.

And just as inflation in the United States would have more serious effects on the world economy than inflation in any other country, so an abrupt downturn in our economy would also be more harmful to the entire world than a downturn in any other country. Our economy is distinguished from all others in that the United States is the only country that makes a large contribution to international trade and finance, but whose international transactions, despite their absolute magnitude, are equal to a very small fraction of its domestic sector.

Hence, a downturn in our economy would pose not only great risks to prosperity abroad but would also be unlikely to be effectively stopped by the continuation of prosperity in the rest of the world. For this reason, the United States must take even greater care than other countries to avoid the use of anti-inflationary measures in a way that would risk to overshoot their mark and to bring about a recession. It is no longer true that when the United States sneezes the rest of the world catches pneumonia; but it still is true that if our economy were to become seriously ill, the rest of the world could hardly hope to escape contagion.

For our own sake as well as for the sake of the entire free world, all our efforts need to be directed toward the twin goals of preserving the dynamism of our economy while maintaining financial equilibrium in our domestic and international transactions.

Under present conditions, monetary restraint is an indispensable part of these efforts. But it is only a part and it should not, and cannot, be made to bear the entire burden.

Attach to memo circulated 8/10/66 containing other copies of original letters regarding discount window.

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

~~Mr Sherman~~
Mr Holland
Mr F. Solomon

FEDERAL RESERVE BANK OF CHICAGO

OFFICE OF THE PRESIDENT

August 15, 1966

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Gentlemen:

This is in response to your letter dated July 19 wherein you indicated it would be helpful if the Presidents and Discount Officers of all Federal Reserve Banks would review carefully the administration of their discount windows.

With the waning of "reluctance to borrow" on the part of member banks, the fuller investment of their funds, increased pledges of their investment securities to an ever enlarging group of preferred public depositors and an intensified squeeze on the net earnings of some banks, we believe Regulation A, in its present form, is being put to a severe test. We do, however, agree that this is not an appropriate time to change the provisions of the Regulation, either formally or informally.

We have discounted notes for many "first-time" borrowers during recent months, and have noted their approach to the discount window was not accompanied by fear or reluctance to borrow. Their reasons for borrowing appeared appropriate, and their unwillingness to seek higher costing federal funds or CD's economically wise.

Many banks are encountering increasing difficulty adjusting for sudden withdrawals of funds, especially when the amounts are large. With banks being more fully invested, a number have been forced to the window repeatedly for this uncontrollable reason rather than by choice or design.

In numerous cattle feeding areas seasonal peak periods of credit demand are giving way to steady demands at higher levels. This is a phenomenon not contemplated by the agriculturally slanted discount (nine months) provisions of the law and regulation. Also, today, the manufacturing lead time in many industries greatly exceeds the 90-day discount provision.

In the past six months we have had to visit with a number of banks concerning inappropriate use of our discount window. This has included borrowing to purchase from brokers and carry high yielding loans secured by convertible bond collateral and selling high priced federal funds while indebted to us.

Many bankers have been cautioned that they cannot avail themselves of every attractive investment opportunity that comes their way unless they already have available loanable funds. In a few areas banks have attempted to improve their public images by increasing their real estate mortgage lending as savings and loan associations curtailed theirs, with the hope they could lay off the loans acquired with big city correspondents and insurance companies. Their expectations for relief proved unrealistic and some troublesome and costly asset adjustments resulted.

By and large, we believe Seventh District member bankers have a fairly good understanding of what constitutes appropriate use of the discount window and we have been surprised that we have not had more borrowing requests.

Fall loan demands of member banks are expected to be quite heavy, and with the present low discount rate structure we expect to experience administrative difficulties in assuring ourselves that all borrowings are appropriate.

We have no further comments at this time other than the belief that, as stated above, any policy changes in the administration of the discount windows should await completion of the Reappraisal of the Discount Mechanism.

Sincerely,

Charles J. Scanlon

Charles J. Scanlon

Add to the copies of the original letters distributed August 11, 1966, regarding the discount window.

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

Mr. Sherman
Mr Holland
Mr F. Solomon

FEDERAL RESERVE BANK
OF ATLANTA
ATLANTA, GEORGIA 30303

OFFICE OF
PRESIDENT

August 9, 1966

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Sherman:

I have reviewed with considerable interest your letter of July 19 regarding reasonable uniformity of administration of the discount window consistent with current objectives of monetary policy.

While we have had some expansion in the number of borrowing banks, attributable specifically to country banks, our administrative policies are generally consistent with those set forth in your letter. We have experienced the expansion of credit and the shift of demand out of the larger financial areas into smaller banks.

So far as we are able to determine, there have been no instances of banks deliberately using Federal Reserve credit to profit from the rate differential in the Funds market. However, there have been some few instances of banks selling funds while indebted to us at the window occasioned by unexpected deposits late in the day, demands made by correspondent banks too late to adjust and for other similar reasons. We have communicated with all banks in the District and advised that such practice was not an appropriate use of Federal Reserve credit.

Sincerely yours,

Harold T. Patterson

Harold T. Patterson
President

Mr. Martin

This was mailed to you in Maine on 8/19.

mnm

To be considered at the joint meeting of the Presidents, August 23, 1966.

Chairman Martin

**FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.**

STRICTLY
CONFIDENTIAL

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

August 19, 1966.

STRICTLY CONFIDENTIAL

Dear Sir:

Enclosed is a staff draft of a proposed memorandum regarding the coordination of discount window administration with other monetary policy instruments. This preliminary draft of statement has been prepared at the Board's direction and is being distributed for study by the Board members and the Presidents prior to the joint discussion of the subject on Tuesday, August 23.

While the draft of memorandum is strictly confidential, you should feel free to discuss it with your discount officers or other officials at your Bank. The Board is seeking the best thought in the System looking toward even better coordination between discount administration and other instruments of monetary policy.

Very truly yours,

Merritt Sherman

Merritt Sherman,
Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS.

STRICTLY CONFIDENTIAL (FR)

August 19, 1966.

DRAFT MEMORANDUM ON COORDINATION OF DISCOUNT ADMINISTRATION WITH OTHER INSTRUMENTS OF MONETARY POLICY

A. Policy Background and Objectives

1. The current economic and financial situation is giving rise to special pressures on Federal Reserve discount facilities, but it is also creating special opportunities for discount administration to contribute to effective monetary policy, provided that timely, appropriately oriented, and reasonably uniform adaptation of discounting procedures can be achieved. This memorandum outlines the means by which such an objective may be sought.

2. The current economic situation is generating extraordinary demands for credit, rising interest rates, and substantial dislocations in flows of funds, both among financial intermediaries and between intermediaries and market instruments. The impacts of such credit pressures have been uneven, with particular effects on housing and potentially on state and local governments.

3. In this environment, it is the current aim of monetary policy to restrain the pace of credit expansion, particularly bank credit expansion, while achieving a somewhat better balance of such restraint among the various categories of final credit users. A secondary but nonetheless important qualifying consideration is the desire to avoid disruptions of financial processes.

4. In implementing current monetary policy, the Federal Reserve has relied on several measures of restraint, some conventional and some novel:

(a) Through open market operations, reserve availability has been progressively restrained relative to demand in a fashion typical of most business expansions of the 1950's and 1960's.

(b) In addition, however, reserve requirements have been raised twice, the first such unilateral action in 15 years.[1/]

(c) Besides such action on the reserve supply front, the System has also recently been taking some steps to inhibit bank ability or willingness to seek funds from other sources. Ruling that promissory notes were deposits and reducing the rate ceiling on multiple-maturity deposits were two actions of this type. In addition, the Board has maintained the Regulation Q ceiling on single-maturity CD's. With market rates on competitive instruments now higher in some cases than on such CD's, a good many larger banks undoubtedly are facing substantially larger CD run-offs than they might have anticipated even a few weeks ago.

(d) Given the above constraints on supply of reserve and non-reserve funds, banks have been scrambling hard for remaining nondeposit-types of funds, (e.g., borrowing outside the System) at progressively higher rates. In addition, banks will undoubtedly be led to increase their demand for accommodation at the discount window. In this connection, bank attitudes toward borrowing may have been affected by mention of this possible avenue of relief in the Board's press statement concerning the increase in reserve requirements on time deposits.

1/ An upward adjustment from 11 to 12 per cent in the reserve requirement on demand deposits at country banks was introduced in November 1960, coordinate with the action making all vault cash reserve-eligible.

(e) In the meantime, the discount rate on Federal Reserve credit has been held down, because, in the Board's judgment, there has been more to be lost than gained from the announcement effect of an increase. Supporting reasons for maintaining the discount rate unchanged at this juncture were cited in the Board's letter of July 16 to the Reserve Bank Presidents.

5. In view of these developments and the current environment, it becomes essential to have a discount policy that, besides performing the usual kind of "cushioning" function, will do four particular things:

(a) provide an extra degree of cushioning against extraordinary pressures that might concentrate at certain points in the banking system, particularly because of substantial run-offs of CD's;

(b) counter, at least partly, the demonstrated tendency for banks to respond to credit restraint by running down their net liquidity and selling portfolio investments while postponing effective restriction of lending policies, particularly with respect to loans to good business customers;

(c) avoid releasing so much reserves in the cushioning process as to erode the effectiveness of overall credit restraint; and

(d) accomplish all this with a minimum of disruption and confusion and a maximum of uniformity in the treatment of similar cases.

The discount window is uniquely suited to undertaking these tasks. No other existing monetary policy instruments, singly or in combination, are likely to be able to achieve them.

B. Implementing Stated Discount Policy Objectives

It is conceived that the best approach to the above discount policy objectives is to develop a set of general guidelines extending the present interpretation of the meaning of Regulation A at those points that will come under greatest stress in the current and prospective situation. This should leave substantially intact the intent and philosophy of the Regulation, the present administrative apparatus for policing the discount window, and the traditional "rules of the game" for dealing with the conventional kinds of member bank needs for temporary, seasonal, or emergency credit assistance. The recommended supplementary guidelines are listed in succeeding paragraphs.

1. Borrowing member banks shall be considered for greater than usual accommodation at the discount window when the clear proximate cause for their borrowing is one of the following:

(a) a sharp run-off of CD's or savings deposits which the bank is unable to replace because of the Regulation Q rate ceilings (it is not intended as a prerequisite for this type of discount accommodation that the member bank should be required to engage in maximum promotion of small consumer-type CD's at ceiling rates in an endeavor to offset, insofar as it can, run-offs of either large CD's or savings deposits).

(b) a sudden and substantial drying up of non-Federal Reserve sources of borrowed funds (Federal funds, RPs with corporations, loans from correspondents, transfers from foreign branches) on which the bank had previously relied to finance its position;

(c) an increase in reserve requirements against deposits;

(d) temporary credit extensions to finance, directly or indirectly (through loans to recognized dealers or underwriters), minimum underwriting activities essential to the continued functioning of securities markets.

2. Repayments of any borrowing undertaken for reasons cited in Item B. 1. above shall be expected on a reasonable and orderly basis, but Federal Reserve Bank officials should encourage banks to obtain funds for such repayment by adopting more restrictive lending practices in preference to selling off investments, borrowing funds elsewhere, or soliciting consumer time deposits more aggressively. For this purpose, Reserve Bank officials should contact each borrowing bank as early as practicable in its borrowing span to ascertain the cause of borrowing and, if other than a purely temporary case, to raise the question of adjustment of bank lending policies. If, and only if, the borrowing bank indicates that its need for borrowing arises from causes cited in Item B.1. above <u>and</u> demonstrates that it is in fact tightening lending policies significantly, it may be allowed to borrow for a more extended period than would otherwise be allowable under the present interpretation of Regulation A. How much longer will have to be a matter for judgment by the discount officer, but it should be contingent upon continuing and substantial progress in curtailing new loan commitments (although not ceasing them altogether).

3. Encouragement of tightening of lending policies, as recommended in Item B.2., should not extend to Reserve Bank specification of particular borrowers or classes of borrowers to be curtailed. Varying bank-customer relations and the long-run efficiency of private decisions in this area need to be respected. What can be done, however, is to urge banks not to exempt any major category of customer (and especially not business customers) from some degree of tightening, and urge them to encourage their customers, of all types and sizes, to hold down their loan requests as much as possible.

4. Additionally, banks borrowing for any except very infrequent and temporary needs should be encouraged to maintain their net liquidity at a reasonable level. This point of view should be pressed strongly with any bank borrowing under the terms of Items B.1. and B.2. above. While such banks should not be led to borrow extra funds from the Federal Reserve simply to buy liquid assets or reduce their borrowing from others, they should be pressed to continue their tightening of loan policies beyond the point that permits repayment of current Federal Reserve indebtedness, whenever such extended tightening is needed in order to permit some rebuilding of their liquidity positions to an appropriate level over a reasonable period of months. An "appropriate" level of liquidity cannot be defined with any assurance. As a rough rule of thumb, however, a discount officer might use as a normative value the liquidity position of the typical bank in the borrowing bank's reserve class and size range. This would be in effect measuring the banker against the demonstrated judgment of his peers.

5. If a borrowing banker, rather than submit to a program of tightening loan policies and rebuilding liquidity in order to gain added discount accommodation, decides to effect his adjustment through other means (e.g., selling investments, borrowing funds elsewhere), he should be allowed no more discounting assistance than would accrue to him under the present interpretation of Regulation A. The latter standards should be strictly observed, as underlined in the Board's letter of July 19, 1966, and the responses thereto by the Presidents.

6. To support the indicated administrative activities, Reserve Banks should feel free to call on borrowing banks for whatever reasonably available data might help to illuminate the relevant circumstances. For example, when the bank's regular reports of loans outstanding are not indicative of tighter policies because of current take-downs of previous commitments, separate and regular reports on new loan commitments should be requested. Borrowing banks should be asked to report regularly on their borrowings from non-Federal Reserve sources, in order to permit a suitable up-to-date judgment of their liquid liabilities to offset against their liquid assets. If, in the judgment of the Reserve Bank, the borrowing bank's liquid asset position is not sufficiently revealed by other reports, a special supplemental report on such assets could also be requested periodically.

7. To help in coordinating open market operations and other aspects of monetary and regulatory policy with these adaptations in discounting, special supplemental reports to the Trading Desk and the Board would be needed:

(a) Daily report on the total dollar amount of borrowing and number of borrowing banks known to fall into categories shown in Items B.1.(a), (b), (c) and (d) above, and thus eligible for the extra adjustment credit described in Item B.2.

(b) Daily report on the total dollar amount of borrowing and number of borrowing banks making use of the additional adjustment assistance credit specified in Item B.2. above, in exchange for commitments to their Reserve Banks to adjust their lending policies.

(c) Brief but regular comments on the extent of problems, or lack thereof, arising at each Reserve Bank in administering discount facilities in this fashion. These reports might need to be weekly at first, but less frequent later on.

The Board recognizes that the program herein outlined places a very heavy responsibility upon the discount function, and may well involve heavy demands upon Reserve Bank resources. If a program of this sort can be carried through, however, it will make a major contribution to the effectiveness of System monetary policy, at a vital time--a time when monetary policy is carrying a very heavy load in the struggle to resist inflation.

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

~~Mr Sherman~~

Mr Holland

Mr F. Solomon

FEDERAL RESERVE BANK
OF ATLANTA
ATLANTA, GEORGIA 30303

OFFICE OF
PRESIDENT

August 19, 1966

CONFIDENTIAL (F.R.)

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Sherman:

This is in response to the Board's letter dated August 15, 1966 regarding the administration of the discount window as commented upon during the recent examination of this bank.

Subsequent to the examination, the policies and procedures followed in the administration of the discount window were discussed in detail with the Executive Committee of our Board of Directors, especially the criticisms mentioned by the Chief Examiner. A discussion also was held with our full Board in Executive Session at its meeting the following morning. Each member of our Board had been furnished with a copy of the Board's letter of July 19 with respect to the policies to be followed. I would like to say that our Board is very sensitive to the appropriate administration of the discount window in this District and that it conforms to Regulation A and the objectives of current monetary policy.

As our records will show, there is no loan made to any bank in this District that is not reviewed by our Executive Committee. In regard to the insufficient documentation in the files of the Discount Department, we are now placing a memorandum in the files of all phone conversations with borrowing banks that pertain in any manner to the bank's indebtedness with us.

Sincerely yours,

Harold T. Patterson

Harold T. Patterson
President

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

CONFIDENTIAL (F.R.)

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

AUG 15 1966

Mr. Harold T. Patterson, President,
Federal Reserve Bank of Atlanta,
Atlanta, Georgia 30303.

Dear Mr. Patterson:

The Board has just received an excerpt from the report of the recently concluded examination of the Federal Reserve Bank of Atlanta relevant to the administration of the discount window. From this it appears that the pattern of borrowing in the Atlanta District may not be consistent with Regulation A, and the present stance of monetary policy. The examination report notes that the documentation in the files of the Discount Department is insufficient and that borrowing banks may not have been communicated with in a timely fashion.

The Board has your letter of August 9, 1966, and understands that the entire matter was to be reviewed by the Executive Committee of your Board. It would be appreciated, therefore, if you would inform the Board as promptly as possible regarding the Executive Committee's discussion of the matters referred to with particular reference to the conclusions reached and actions planned or taken.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

Mr. Sherman

CONFERENCE OF PRESIDENTS
of the
FEDERAL RESERVE BANKS

August 26, 1966

Board of Governors
of the Federal Reserve System
Washington, D. C. 20551

Dear Sirs:

The discussions which took place at the joint meeting of the Presidents with the Board last Tuesday morning revealed a surprising degree of unanimity of view among the Presidents. This was especially evident in the widespread feeling that insufficient time was being allowed for a careful review of the proposition presented in the draft memorandum under discussion. This reaction arose out of past experience, which underscores the desirability of deliberately evaluating any significant change under consideration, be it a policy or an operational matter. Such full and frank exchanges of view are among the System's greatest sources of strength, and they certainly should be preserved.

The discussions closed with the statement by Acting Chairman Robertson that the views expressed would be considered further by the Board in reaching its final position. If the Board should decide to press ahead after considering these views, I urge on behalf of all members of the Conference that it allow time both for a careful review of the proposed policy by System discount officers and for further discussions with members of the Conference.

Very truly yours,

Edw. A. Wayne

Edw. A. Wayne
Chairman

~~Mr. Sherman~~
Mr Holland

FEDERAL RESERVE BANK OF SAN FRANCISCO

SAN FRANCISCO, CALIFORNIA 94120

Copies sent to
Mr Holland

August 26, 1966

Board of Governors of the
Federal Reserve System,
Washington, D. C. 20551

Dear Sirs:

This refers to the Board's letter dated August 19, 1966, and the staff draft of a proposed memorandum enclosed therewith, regarding the coordination of discount window administration with other monetary policy instruments. Subsequent to the discussion at the Board on August 23, this subject has been given further consideration and we do not favor adopting the policy==in its fullest implications--set forth in the draft memorandum, for the reasons stated below. If it is believed that the need to curtail loans selectively has reached the proportions which might be implied in the draft memorandum, we believe voluntary credit restraints imposed on all financial institutions should be sought. In addition, legislation which would give the Board authority to adopt selective credit controls presumably would also be in order.

As we understand the proposed program, it is intended to facilitate the flow of Reserve System credit through the discount window in greater measure to those banks which experience unusual pressures in the current economic environment--particularly those arising from a runoff of large CD's --provided such banks "submit" to a program of significant tightening in particular lending policies and a rebuilding of liquidity. The impact of the proposed policy would fall on the borrowing banks only. If general credit restraints need modification at this time to effect selective loan curtailment, we would prefer voluntary guidelines applicable to all institutional lenders instead of restricting only those member banks which borrow from the System, leaving unaffected other member banks and all nonmember banks to say nothing of other financial institutions. We believe it not only desirable but necessary that the System stand ready to advance funds through the discount window to member banks experiencing the pressures mentioned above, but we do not believe accommodation should be available only to those member banks which are willing and able to curtail certain types of loan activities. Certainly under Regulation A advances would be appropriate even though other sorts of adjustments were undertaken by the borrowing banks.

On the other hand, we would preclude neither the possibility of extended borrowing nor indirect encouragement of loan curtailment. If, in connection with the type of borrowing under consideration, it develops that a member bank chooses to repay in an orderly manner through loan liquidation --rather than, for example, by sale of investments--it should be recognized that such borrowings probably would be outstanding for a more extended period of time, and, indeed, this might be a factor in a bank's choice of this avenue of adjustment. Despite the problems of defining an appropriate "more extended period of time", we would have no objection to this and think such a policy could be adopted within the present framework of Regulation A. This would permit the borrowing bank to judge whether its interests are best served through one type of internal adjustment as compared to another. We are not implying that we avoid discussion of various means of adjustment with a borrowing bank. However, we do not believe that we should require a borrowing bank to curtail lending, liquidate investments, issue promissory notes, or take some other particular action to repay its debt to its Reserve Bank. To substitute our judgment for that of the member bank, we suggest, implies a question regarding the competence of management of the member bank, or at least doubt that the management will take the action we think it should. Only when an individual bank is in a most adverse and serious situation should our judgment on sources of repayment be imposed on a borrowing member bank. The proposed mandate to borrowing banks to build up their liquidity is a somewhat separate issue, but one subject to the same objections.

If one interprets the intent of the draft memorandum in a more minimal sense, however, it seems to us to be not too far out of line with our position that borrowing for longer periods be permitted banks which choose loan liquidation. If the proposed policy should go no farther than this, we do not believe any supplement or amendment to Regulation A is necessary or desirable. In our opinion, this has already been brought to the attention of all member banks and the public in the last paragraph of the Board's press statement dated August 17.

Apart from the general questions raised hereinabove and even though we do not favor the draft memorandum, the comments which follow relating to its specific provisions may be of interest.

<u>Page 1</u> A. <u>Policy Background and Objectives</u>

3. ". . . , while achieving a somewhat better balance of such restraint among the various categories of final credit users."

From this phrase, one must assume that (1) a "better balance" would result automatically from demonstrated general loan restrictions at borrowing member banks, or (2) some specific guidelines would be furnished borrowing member banks to bring about the "better balance" sought. If one agrees a "better balance" is necessary or desirable, it could not be said that loan curtailment per se would bring about a "better balance." As guidelines are not being suggested at this time (see B.3., page 6), we suggest that the phrase quoted above from A.3. be deleted, for it seems to be in conflict with what may be accomplished within the proposed framework.

<u>Page 2</u> A.4.(c) Line 4. We suggest "short-term" be inserted between the words "that" and "promissory."

Page 3. A.5.(b) It is provided herein that it is "essential to have a discount policy that also will counter, at least partly, the demonstrated tendency for banks to respond to credit restraint by running down their net liquidity and selling portfolio investments while postponing effective restriction of lending policies, particularly with respect to loans to good business customers."

We are unable to rationalize this view with the General Principles set forth in the Foreword to Regulation A. The question of maintaining an appropriate level of liquidity rests primarily in the supervision of banks by the proper authority, not, we submit, in the formulation or administration of discount policy.

Page 4. B.1.(a) Greater than usual discount accommodation is to be considered for banks requiring funds because of "a sharp runoff of CD's or savings deposits which the bank is unable to replace because of the Regulation Q rate ceilings."

This implies that a bank must pay the ceiling rates prior to consideration for special accommodations at the discount window. Some well-managed banks may not wish to engage in the rate war for time deposits and, therefore, lose significant amounts of such funds. We believe such member banks should not be treated less favorably than those members paying Regulation Q ceiling rates but which have lost deposits.

B.1.(b) This paragraph provides for more than usual accommodation for a member bank experiencing a loss of substantial non-Federal Reserve sources of borrowed funds upon which the bank previously had relied to finance its position. Although the System may find it necessary in the final analysis to lend support to such member banks, we are not sympathetic toward the management of a bank which, to take advantage of interest differentials, operates in a constant deficit position requiring at all times short-term borrowed funds for the maintenance of legal required reserves. Unless no reasonable alternative existed, we would not consider it appropriate to provide discount accommodations for an extended period to such an institution.

Page 5. B.1.(d). This provides for greater than usual discount relief to a member bank requiring funds because of the temporary needs of recognized dealers or underwriters to cover minimum underwriting activities essential to the continued functioning of securities markets. We agree that the purposes here are worthy, but we do not see the necessity of singling out for special mention borrowings by member banks for such purposes, since we would view such advances as being within the intent of the Foreword to Regulation A.

Page 6. B.4. Banks are to "be encouraged to maintain their net liquidity at a reasonable level." This, again, raises the question of the relationship of bank supervision to the discount administration. (See our comments under A.5.(b) above.)

Page 7. B.6. The problems of interpreting data on loan commitments were brought out during the August 23 discussion, and we simply wish to emphasize them again.

Yours very truly,

Eliot J. Swan

Eliot J. Swan,
President.

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

STRICTLY CONFIDENTIAL

MEMORANDUM

STRICTLY CONFIDENTIAL (FR) August 26, 1966.

TO: Board of Governors SUBJECT: Revision of

FROM: Robert C. Holland discount administration program

As directed by the Acting Chairman, the staff is undertaking revisions of the draft program for discount administration (memorandum dated August 19, 1966) in the light of oral comments by the Reserve Bank Presidents at the joint meeting on August 23 and written comments expected to be received by August 29. Pending distribution of the minutes of the joint meeting, I have prepared the attached draft reference list of issues raised orally by the Presidents.

Discount officers from three Reserve Banks (New York, Philadelphia, Chicago) will be meeting with the staff on Monday to modify and reformulate one or more versions of the program in ways that might be operationally feasible, depending upon how the Board resolves the basic issues of principle involved. Attached is a rough outline of one possible set of implementing arrangements, assuming a particular set of Board decisions as to the issues of principle cited. The staff would appreciate any guidance that the Board members might be moved to give, individually or collectively, concerning the use of this material as grist for the staff revision effort Monday.

The staff drafting group will be meeting in Room 2019 beginning at 9:30 a.m. Monday. Governor Mitchell will make some opening remarks and the group is invited to lunch with the available Governors at 1:00 p.m. in the Blue Room.

Attachments (2)

STRICTLY CONFIDENTIAL (FR) August 26, 1966.

REVISED DISCOUNT ADMINISTRATION PROGRAM

II. POSSIBLE COMPROMISE PROGRAM

A. Issues of principle involved (to be resolved by Board, after consideration of comments by the Presidents):

1. Allocation of credit:

Some tightening of lending policies, and some corresponding lightening of bank securities sales, but minimum of interference with bank decisions as to what borrowers get credit.

2. Release of reserves:

Moderate net increment of reserves to be released.

3. Extent of publicity:

Only borrowing banks in need of adjustment contacted explicitly, but general theme might be mentioned in speeches, etc.

B. Implementing procedures needed (to be developed by staff):

1. Only banks to be explicitly contacted would be those who ordinarily would be due for contact by discount officer in any event, because of their borrowing record.

2. Discount officer to raise question of possible resort to curtailment of new lending as one among several possible avenues of adjustment, with the banker left free to pick which means of adjustment he might prefer in the circumstances.

3. Banker to be encouraged to consider loan curtailment, especially business loan curtailment, as action in the public interest--a way for him to contribute to the fight against inflation that is the

key current objective of monetary policy. Emphasis that choice of borrowers to be cut back is up to him.

4. If borrowing bank decides to undertake loan curtailment as a means of adjustment, it should be allowed as much--but no more--time to repay its borrowing as would have been allowed by discount officer if the bank had made such an adjustment choice without special Federal Reserve encouragement. Hence, there is no need for definition of any special added borrowing privileges. However, so long as loan curtailment proceeds at reasonable pace, there would be no Federal Reserve pressure to accelerate repayment of borrowing by pressing for sale of any free investments.

5. Net additional reserves released under this program should be fairly moderate. Presumably some more borrowing banks would choose to adjust by curtailing loans in preference to other means (e.g., selling investments, borrowing elsewhere, pushing small CD issuance), and presumably such adjustment would take longer than would adjustment by sale of securities. Hence, the average amount of borrowed reserves outstanding would probably be larger than otherwise, but not greatly so.

6. Banks would not be invited into the window (no "circumstances qualifying banks for special assistance," as suggested in the August 19 memo), but as occasions arise banks could be reminded that if they found themselves under more pressure than they could handle (e.g., from CD run-offs), the discount window was available

as a lender of last resort, adding the comment that it would be hoped that they would conduct their adjustment programs, including borrowing, in a manner consonant with the public interest in (a) orderly financial processes, and (b) fighting inflation.

STRICTLY CONFIDENTIAL (FR) August 26, 1966.

SUMMARY OF COMMENTS BY FEDERAL RESERVE BANK PRESIDENTS
ON DRAFT MEMORANDUM ON COORDINATION OF DISCOUNT ADMINISTRATION
WITH OTHER INSTRUMENTS OF MONETARY POLICY
AT JOINT BOARD-PRESIDENTS MEETING, AUGUST 23, 1966

1. Monetary policy should not be used to influence allocation of credit among various users; at least, discount policy should not be so used.

2. CD run-offs can be handled adequately under existing Regulation A.

3. Extending credit beyond regular Regulation A limits would create problems for open market operations, as follows:

   a) would release too much reserves, easing credit restraint;

   b) would require offsetting open market operations of a size that could strain the securities market;

   c) would require more carefully thought through integration with open market operations.

4. Proposed program would create bank and public relations problems:

   a) disrupt existing member bank understanding of dis count mechanism;

   b) would aid aggressive, illiquid banks the most;

   c) raises questions as to how much publicity to give program (Board's announcement has already stirred up questions);

   d) any significant change should be made openly, not secretly;

   e) would be difficult to communicate accurately to banks other than borrowing banks, but inadequately effective if applied only to banks after they come to discount window.

5. Numerous problems of practical definition and measurement:

   a) amount of extra borrowings;

   b) new loan commitments;

   c) needs for financing underwriting;

   d) kind of member bank commitment to Reserve Bank to reduce lending, and for how much and how long;

   e) orderly adjustment;

   f) liquid liabilities.

6. Difficult to insist on banks' maintaining or rebuilding liquidity when they are under pressure; that is precisely the kind of need for which banks would expect to use their previously husbanded liquid resources; to effect better bank liquidity, need supervisory standards.

7. Proposed program might involve extra borrowing by many banks, small as well as large, in preference to borrowing elsewhere, with large number of cases hard to handle.

8. Will be hard to achieve uniformity of administration of the proposed program; on the other hand, discount administration under existing Regulation A procedure is regarded as sufficiently uniform to cause no serious problem.

9. Not logical or necessary to link reserve adjustment of individual bank to general monetary policy.

10. Would result in rising borrowings that would soon require discount rate increase to help control.

11. Proposed program is too specific or mechanical, out of keeping with more generalized language of Regulation A.

12. A workable minimum program would simply be to have discount officers increase their emphasis on loan tightening as compared with investment liquidation in contacting borrowing banks regarding adjustment.

13. More study of proposal needed, and situation not so pressing but that several weeks could profitably be spent on review and discussion of idea. Proposal represents a basic change in discount administration; perhaps should be reviewed by committees responsible for the longer-range discount study.

Mr Sherman
Mr Holland

FEDERAL RESERVE BANK OF CHICAGO

copies sent to
Mr Holland

OFFICE OF THE PRESIDENT

August 26, 1966

Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Gentlemen:

This letter supplements my oral comments of August 23 on the staff draft of a proposed memorandum regarding the coordination of discount window administration with other monetary policy instruments, dated August 19.

It has been difficult to achieve uniform administration of the discount windows under the 1955 interpretation of Regulation A, as is demonstrated in Bernard Shull's recent analysis. We believe that any change in policy which placed greater reliance upon discretionary decisions of discount officers would cause still greater problems in achieving uniformity of administration, at least for some considerable period of time. Furthermore, since it is reasonable to assume that the extensive study of the discount function now under way will lead to some modifications of discount policy, it would be undesirable to suggest to member banks that standards of appropriateness of borrowing are being changed now. We have succeeded recently, we think, in obtaining relatively good understanding on the part of our member banks of what constitutes appropriate use of the window. We are fearful that frequent changes in administrative standards--real or apparent--would make it nearly impossible to maintain reasonably good understanding of policy by the member banks and reasonable uniformity of administration by the Reserve Banks.

The months ahead may present critical problems for a number of commercial banks and certain segments of the securities markets. However, we feel that such situations are provided for under the existing "principles," as described in the introduction to Regulation A, which state that Federal Reserve credit is available to meet "unusual situations" and

Board of Governors of the
Federal Reserve System

August 26, 1966

"exceptional circumstances." The cases cited under Section B.1 of the memorandum would appear to be covered by these provisions. We agree that these cases, unless accommodated, could result in serious problems in the current environment and should, therefore, be regarded as appropriate reasons for borrowing. It is our view that no special steps are needed to inform bankers of this posture. In the present circumstances, applications for advances are very likely to rise as a result of any of these developments without any special encouragement by the System.

As Mr. Shull's analysis strongly suggests, the appropriateness of purpose of borrowing is largely a matter of whether, in fact, the borrowing turns out to be of short or long duration. The real question, then, is how soon should the borrowing be liquidated. It still seems appropriate to discourage individual banks from making continuous use of the window. But if we undertake to provide more of the reserve expansion in the months ahead through the discount window, more and more banks, especially the large ones, will come to the window. We can then move somewhat less promptly and less vigorously in getting them out if they are faced with any of the four problems the memorandum poses as deserving of special consideration and are exercising appropriate restraint in their loan policies. This would follow without engaging in discussions which would cause banks to surmise that basic discount policies had been changed.

Meanwhile, Federal Reserve officials could include in speeches or other statements comments on the objectives of monetary restraint and the desirability of spreading its impact to all sectors of demand including commercial and industrial loans. They could also stress the responsibility of managers of private financial institutions to maintain reasonable liquidity so as to assure a sound financial structure generally and viability of individual firms.

We feel that "deals" with individual banks, as suggested in Item B.2 and again in Item B.7.(b) of the memorandum, would be inappropriate and impossible to administer equitably. Moreover, we would be at a loss to determine specifically the appropriate length of a "more extended" period of borrowing. This should be decided on the basis of the circumstances in each case, with continuous exchange of information between discount officers and between the Reserve Banks and the Board serving to maintain reasonable uniformity of administration.

Board of Governors of the
Federal Reserve System

August 26, 1966

With respect to the suggested attempt to set liquidity standards as a part of the discount operation, we believe such a policy would not be workable. Indeed, it could backfire; for if bankers believe the window has been opened wider, many banks--not necessarily borrowing banks--may be tempted to further reduce alternative sources of liquidity. In any case, we do not feel that it is possible to develop specific criteria with respect to either loan trends or liquidity positions of individual banks that could provide a rational basis on which to distribute credit among member banks. There is a danger that efforts to develop and implement such criteria would lead some banks to conclude that the System is unwilling or unable to fulfill its role as an ultimate source of liquidity for the banking system. This would be very unfortunate.

We believe, therefore, that anticipated problems can be dealt with under existing interpretations of Regulation A while substantially achieving the policy objectives stated in the staff memorandum. While discount officers should continue to require necessary information from banks on which to base lending decisions, we do not believe that this necessitates an expanded System-wide reporting program at this time or that the Manager of the Open Market Account can utilize effectively, or should attempt to utilize, information on bank borrowings by purpose in conducting open market operations. Information on total borrowings is more relevant to his responsibilities.

Sincerely,

Charles J. Scanlon

Charles J. Scanlon

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

to be revised

STRICTLY CONFIDENTIAL (FR) August 29, 1966. STRICTLY CONFIDENTIAL

TO: Board of Governors

FROM: Robert C. Holland

SUBJECT: Development of revised program for discount administration.

Pursuant to the direction of the Board, discount officers from the Federal Reserve Banks of New York, Philadelphia, and Chicago met today with members of the Board's staff in an endeavor to develop a practical program for adapting discount administration insofar as feasible to the restraint of business lending. Attached are the results of that meeting, in the form of two drafts:

(1) "Revised Program for Discount Administration in the Current Economic Environment", and

(2) "Letter to Member Banks Concerning Need to Restrain Business Lending".

While the discount officers had at their disposal the Board staff memorandum of August 19, 1966, "Draft Memorandum on Coordination of Discount Administration with Other Instruments of Monetary Policy", and a summary of the oral comments and selected written comments of that memorandum by the Federal Reserve Bank Presidents, they found it most practicable to develop fresh language for the attached documents. The program encompassed in these documents, they believe, represents as far as the System can feasibly go in adapting discount administration to the objectives which the Board has expressed, so long as the existing institutional framework is to be maintained. The kinds of contacts with member banks proposed in this program they regard as no more than an extension of the kinds of representations concerning total loan curtailment that have already been made by some discount officers to their member banks.

The discount officers caution that the effectiveness of the program suggested below will be hard to measure, and will probably be no more than modest at best. Furthermore, they feel this program may not remain viable if business needs for bank credit to finance defense production should accelerate.

While all the caveats expressed by the discount officers may be well taken, I think the program herein presented represents an effort in the direction of rebalancing credit pressures that might usefully be undertaken.

If the Board finds this program to be worthy of consideration, copies of it might be forwarded to each Reserve Bank President with a request for his further comment. President Wayne, in his capacity as Chairman of the Conference of Presidents, has written the Board requesting that time be allowed "for a careful review of the proposed policy by System discount officers and for further discussions with members of the Conference." At the moment, the next convenient opportunity for a meeting of the Board and the Presidents would be in conjunction with the Federal Open Market Committee meeting on September 13; and the first practical opportunity for a round-table discussion by System discount officers would be at their scheduled conference, September 19-20. Potential market developments in the interim, however, may very well make it inadvisable to delay until these dates System discussion and final adoption of the program in question.

Attachments 2

DRAFT

FOR INTERNAL SYSTEM USE ONLY STRICTLY CONFIDENTIAL (FR)

August 29, 1966.

REVISED PROGRAM FOR DISCOUNT ADMINISTRATION IN THE CURRENT ECONOMIC ENVIRONMENT

In the current business and financial situation, it is contemplated that it will prove necessary and desirable within the next few weeks and months to impel member banks to borrow substantially greater amounts than at present from their respective Reserve Banks. This would be accomplished by maintaining current Regulation Q ceilings while conducting sufficiently restrictive open market operations so as to give rise to a substantial run-off in CD's or declines in other types of deposits, and perhaps also occasional drying up of sources of inter-bank borrowing.

This operational strategy is deemed necessary in order to slow down the rate of bank credit expansion. From an economic stabilization point of view, however, this strategy can only be effective if the lending policies of the Reserve Banks tend to curtail bank lending to those segments of the economy where the greatest recent expansion has taken place. At the same time, it is necessary that pressures on the banking system do not result in a demoralization of other financial markets, e.g., the municipal market, as the banks endeavor to adjust their positions.

It is believed that Federal Reserve Bank discount administration can help to accomplish the desired objectives <u>within the framework of the present Regulation A</u>. It is likely that in those situations where there is a sharp run-off of CD's or a drying up of inter-bank sources of funds, it may be necessary, as the Regulation in fact has anticipated,[1/] to lend to banks for somewhat longer than usual periods of time. Such longer periods of credit extension would permit the borrowing bank to make some adjustment in the area of business loans rather than concentrating their adjustment in the earning asset categories of investments, real estate mortgages, and other loans.

While discount officers should refrain from making decisions for member banks, they should nevertheless urge the desirability of undertaking adjustments in business loans. In any case, it should be made clear--again in accordance with the present Regulation[2/]--that expansion of business loans at current rates is not in the public interest and will not be condoned while the member bank is in a position of having to borrow from the Federal Reserve Bank.

Indicated needs for industrial credit during the next few months are such that it is altogether likely that member banks will have to forego loans to some well-established prime customers. It is not intended that System policy prevent member banks from meeting legitimate and normal seasonal needs, especially where they have made some preparation to take care of this themselves; it is intended,

---

1/ ". . . Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. . . ." Regulation A, Section 201.0, par. (d).

2/ Regulation A, Section 201.0, par. (e), quoted on page 3.

however, that the seasonally adjusted rate of expansion of business loans shall be reduced.

The emphasis on slowing down the rate of growth of a particular category of loan is a departure from recent discounting tradition and practice. It is felt to be necessary because of the Board's conclusion that the present rate of expansion of business loans is supporting an unsustainable rate of growth of business investment, with unsound consequences for economic and financial conditions. The Foreword to Regulation A has anticipated this possibility. It specifies that "each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally." It is this concern for "sound credit conditions," rooted in the Federal Reserve Act itself, which makes it currently necessary to bring to bear those aspects of discount administration which are designed to deal with unusual circumstances.

While the standards of discount accommodation outlined above can only affect directly those banks that are indebted to the Federal Reserve Banks, the Federal Reserve Banks are encouraged to continue to take the initiative in communicating with any other banks whose general liquidity position and lending activity are such that they might soon need to borrow from the Federal Reserve. The System's policy and the reasons for it should be explained to them in an effort to encourage them to anticipate their needs and to make adjustments in their lending policies that would be appropriate to the situation.

In addition, the examination function will be asked to pay particular attention to the liquidity position of all member banks. Where appropriate, examination officials might be invited to participate jointly with discount officials in contacts with member banks whose liquidity position and lending activity are out of keeping with the program herein enunciated.

The accompanying statement from the Board of Governors addressed to all member banks supplies a public expression of the Federal Reserve's point of view on these matters that may be usefully referred to in discussions with member banks.

STRICTLY CONFIDENTIAL (FR) August 29, 1966.

D R A F T

FOR PUBLIC RELEASE

LETTER TO MEMBER BANKS
CONCERNING NEED TO
RESTRAIN BUSINESS LENDING

It is the view of the Federal Reserve System that currently strong demands for credit need to be restrained in order to hold credit-financed spending within the bounds that can be accommodated by the Nation's physical resources. Business demands for bank credit are particularly intense, and while such credit requests often seem justifiable when looked at individually, the aggregate total of business spending so financed is reaching unsustainable levels and adding substantially to inflationary pressures. Furthermore, such loan expansion is being financed by liquidation of other banking assets in ways that can be prejudicial to other financial markets.

The System believes that it serves the national economic interest to reduce the rate of expansion of bank loans to business, within the context of a program of overall monetary restraint. Accordingly, this objective will be kept in mind by the Federal Reserve Banks in granting credit to those member banks that are led to borrow at the discount window by reason of shrinkages in deposits or other sources of funds. Borrowing banks will be expected to cooperate in reducing the rate of business loan growth as part of the orderly adjustment of their positions. This is in conformity with

Section 201.0, par. (e) of the Board's Regulation A governing lending to member banks:

> "In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. ..."

Federal Reserve credit assistance to member banks to meet temporary, emergency, or normal seasonal demands from their customers will continue to be available in accordance with the standards set forth in Regulation A.

The curtailment of the recent extraordinary rate of business loan expansion is in the interest of the entire banking system. The Board expects all banks to be aware of this consideration, whether or not they need to borrow. Management of bank resources in accordance with the principles outlined above can make a constructive contribution to sustainable economic prosperity.

In connection with Item # 7, Agenda, September 1, 1966. Additional material will be distributed shortly.

Chairman Martin

**FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.**

STRICTLY CONFIDENTIAL (FR) August 31, 1966.

DRAFT

STRICTLY CONFIDENTIAL

LETTER TO MEMBER BANKS
CONCERNING NEED TO
RESTRAIN BUSINESS LENDING

It is the view of the Federal Reserve System that continued orderly bank credit expansion is appropriate in today's economy, though that expansion needs to be moderate enough to keep credit-financed spending within the bounds that can be accommodated by the nation's growing physical resources.

An excessive increase of bank credits, it must be stressed, would add to the inflationary pressures that are already visible. To put the matter in perspective, total bank credit has grown at an annual rate of over 8 per cent during the first eight months of this year, total bank loans at a rate of over 12 per cent, and bank lending to business at a rate of close to 20 per cent. While the growth of total bank credit and total bank lending has moderated somewhat as compared with last year, the rise in business loans has continued strong this year.

The 1966 rates of growth in all three measures have exceeded the rise that occurred in 1961-1964, with the excess in the case of total loans and business loans being very substantial. During that earlier period, prices were relatively steady and unemployed resources relatively large. On the other hand, the current situation, marked by inflationary pressures and relatively full use of resources, is not one in which credit and loan growth can appropriately continue at this year's pace.

Business demands for bank credit have been particularly intense. While such credit requests often appear justifiable when looked at individually, the aggregate total of credit-financed business spending has tended to reach unsustainable levels and to add appreciably to current inflationary pressures. Furthermore, such exceedingly rapid business loan expansion is being financed in part by liquidation of other banking assets and by curtailment of other lending in ways that could contribute to disorderly conditions in other credit markets.

The System believes that the national economic interest would be better served by a slower rate of expansion of bank loans to business within the context of moderate overall money and credit growth. Accordingly, this objective will be kept in mind by the Federal Reserve Banks in granting credit to those member banks that are led to borrow at the discount window by reason of shrinkages in deposits or other sources of funds. ~~As any substantial adjustment through bank liquidation of municipal securities or other investments would add further to pressures on financial markets, the System believes that a greater share of member bank adjustments must take the form of moderation in the rate of expansion of loans and particularly business loans.~~ Borrowing banks therefore will be expected to cooperate in reducing the rate of business loan growth beyond normal seasonal requirements as part of the orderly adjustment of their positions. This is in conformity with Section 201.0, par. (e) of the Board's Regulation A governing lending to member banks:

> "In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. ..."

Federal Reserve credit assistance to member banks to meet temporary, emergency, or normal seasonal demands from their customers will continue to be available in accordance with the standards set forth in Regulation A.

The curtailment of the extraordinary rate of business loan expansion is in the interest of the entire banking system and of the economy as a wh le. The Board expects all banks to be aware of this consideration, whether or not they need to borrow. Management of bank resources in accordance with the principles outlined above can make a constructive contribution to sustained economic prosperity.

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 31, 1966.

To Board of Governors

From Robert C. Holland RCH

Subject: Amplification of Public Statement on Discount Administration Suggested by President Hayes.

President Hayes of the New York Reserve Bank spoke to Governor Shepardson and me yesterday urging the amplification of the proposed public statement on discount administration (cf. my memorandum of August 29, 1966) in the manner attached. He said he had two aims in mind:

(1) He wished to counter what he felt would otherwise be an adverse market impact from the original draft of the proposed letter to member banks.

(2) More important, he felt that the extremely unsettled state of financial markets, abetted by expectations of still tighter monetary policy, needed to be tranquilized by a moderate public statement from the Federal Reserve System, speaking with one voice.

My own judgment is that the first lines of the Hayes draft go a bit too far in recognizing rumors and explicitly denying any intent to tighten credit further; but that with some modifications of such expressions, a blend of his draft and the discount staff draft of August 29 would prove helpful in quieting reactions to the documents inside and outside the System without altering the basic substance of the program. For similar reasons, I believe some moderation of tone in the early pages of the proposed internal System memorandum would also be a good idea. Some suggestions in this same vein have also been received from individual Governors and staff members. If the Board will indicate the general tenor of the revisions which it wishes to have incorporated in these documents, the staff will endeavor to polish up the specific language, clear it as appropriate, and wire the revised text to all Presidents this afternoon for comment promptly.

Attachment

August 30, 1966.

Strains in financial markets have recently been aggravated by reports suggesting that the monetary authorities intend to prevent any further growth in bank credit. In order to prevent any misunderstanding, the Federal Reserve System feels called upon to deny such reports. The growing economy clearly requires a continued growth of both bank credit and bank lending, and the Federal Reserve System is prepared to provide the reserves necessary for such growth.

On the other hand, it must be stressed that growth of credit and lending at an excessive pace would add to the inflationary pressures that are already visible. To put the matter in perspective, total bank credit grew at an annual rate of 8-1/2 per cent during the first seven months of this year, total bank loans at a 14-1/2 per cent rate, and bank lending to business at a 22 per cent rate. While the growth of total bank credit and total bank lending has moderated somewhat as compared with last year, the rise in business loans has actually accelerated.

The recent growth of all three measures exceeded the rise that occurred in 1961-1964, with the excess in the case of total loans and business loans being very substantial. That was of course a period when prices were relatively steady and unemployed resources relatively large. By the same token, the current situation, marked by inflationary pressures and relatively full use of resources, is not one in which credit and loan growth can appropriately continue at the recent pace.

It is the Federal Reserve System's present intention to moderate the growth of bank credit and loans and particularly to discourage excess growth of bank lending to business, while at the same time providing the reserves for a growth of credit appropriate to the present situation.

In implementing this policy, both open market operations and the discount windows at the twelve Federal Reserve Banks will have a role to play. In particular the System is aware that a policy of moderating the growth of bank credit and lending, along with the probability of deposit losses at individual banks, is likely to result in an increase in member bank borrowing at the discount window. The System will be prepared to meet any such legitimate needs, but will expect banks which have experienced unusually rapid growth in business lending to make the necessary adjustment by cutting back on the rate of expansion in this sector. Bearing in mind that any substantial adjustment through the liquidation of bank investments would threaten a further increase in the strains already present in financial markets, the System believes that much of the brunt of member bank adjustments must take the form of moderation in the rate of expansion of loans and particularly business loans.

The curtailment of the recent pace of bank credit and lending to business is in the public interest and in the interest of the entire banking system. In the present inflationary environment, the Federal Reserve System expects all banks to be aware of this whether or not they seek recourse to the discount window.

CHAIRMAN MARTIN

For Information Only

Mr Sherman
Mr Holland
copies to Bd.

FEDERAL RESERVE BANK OF PHILADELPHIA
PHILADELPHIA, PENNSYLVANIA 19101

August 29, 1966

OFFICE OF THE
PRESIDENT

Dear Merritt:

In response to Governor Robertson's request, we are enclosing our views on the Board's draft memorandum of August 19 concerning the coordination of discount administration with other instruments of monetary policy.

Sincerely,

Karl R. Bopp

President

Mr. Merritt Sherman, Secretary
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

FEDERAL RESERVE BANK OF PHILADELPHIA

Comments on the Board's Draft Memorandum of August 19, 1966, concerning the Coordination of Discount Administration with other Instruments of Monetary Policy

As we understand the Board's memorandum of August 19, the very broad objectives of the proposed change in the thrust of discount policy are two-fold: First, to exert a countervailing influence on the tendency for monetary policy to have an uneven impact on the various end-uses of credit (thus (a) tempering inflationary pressures in particular sectors of the economy, such as inventory and plant and equipment spending, and (b) reducing the inequities of monetary restraint and stemming criticism of those inequities); and second, to assure that individual banks and the banking system will not be adversely affected by mounting liquidity pressures. To secure these objectives, the memorandum sets forth "a set of general guidelines extending the present interpretation of the meaning of Regulation A at those points that will come under greatest stress in the current and prospective situation." (Page 4, paragraph 1)

As a corollary to these two broader objectives, the Board's memorandum may be viewed by some as a tactical _tour de force_. By influencing banks to restrict lending instead of liquidating investments in the coming period of credit stringency, upward pressures might be diverted from market rates, thereby (a) helping to avoid criticism of high and rising interest rates on securities and (b) reducing pressures to raise the Q ceiling.

We should like to comment briefly on each of these goals and then discuss some of the technical problems involved in a program of the scope set forth in the memorandum.

The Incidence of Monetary Restraint

Though we share the concern expressed in the memorandum over the uneven impact of monetary restraint, we feel it would be a mistake to attempt to influence the end-use of credit through administration of the discount window. There are several reasons for this:

(1) The discount officer would be placed in the position of advising a large number of banks on questions of overall asset allocation and perhaps even of advising on individual loans. The result would be a substitution (to a greater or less degree) of the discount officers' judgments for those of individual bankers in their own communities throughout the nation. In our opinion, the System's discount officers do not now have and could not readily acquire the background and information needed to make intelligent judgments on the multitude of cases and questions which would come to them for decision.

(2) Implementation of the Board's memorandum would create inequities among individual banks within the banking system. Some banks, anticipating credit stringencies and liquidity pressures, have been restricting credit rather drastically for months. Others have done very little to restrain credit so far. Since a program based on the Board's memorandum presumably would take effect on a given date, the banks which already have taken restrictive action would be penalized relative to the more liberal banks.

In addition, the program would penalize banks which have built up liquid assets in order to meet liquidity pressures from their own resources, relative to other less liquid banks allowed to use Federal Reserve credit to provide for their liquidity needs. Also, the Fed might find it more difficult to sell the liquidity philosophy in the future if it now favors banks which do not pursue such a philosophy.

(3) An attempt to influence the incidence of monetary policy through discount administration -- even if successful in reducing the volume of bank loans relative to other credit -- could actually aggravate the problem of monetary policy's uneven impact in other areas. For instance, since banks are the primary lenders to small business and since pressures to reduce loans would probably fall most on smaller business borrowers, such pressures would tend to tilt the flow of credit to larger firms and away from smaller ones.

(4) There are other ways to influence the allocation of credit, including the direct funneling of capital to particular sectors of the economy through the intermediation of governmental agencies. In view of the problems associated with use of the discount window in policing the end-use of credit, these other channels might prove more suitable if it were decided that a more balanced incidence of credit restraint were an overriding goal of public policy.

(5) Such a fundamental departure from traditional discount policy as that suggested in the Board's memorandum raises many questions and deserves long and careful study. For instance, what are the implications of such a posture for

the System's "independence" in the longer run, for membership in the System, for the System's other policy tools and guides to policy? Should such a program apply just to inflationary periods or to all phases of the business cycle? These are but a few of the questions deserving careful consideration. Since the System now is undertaking a fundamental review of the discount function, a ready opportunity is provided to explore in more depth the issues raised in the memorandum.

(6) The Federal Reserve represents the ultimate source of liquidity to the banking system, a fact which is well-known to bankers. Moreover, the discount window has long been associated with the function of "lender of last resort." To maintain an unquestioned role as the ultimate source of liquidity, the System should avoid attaching strings to the discount window, especially before a period of potential financial crisis.

(7) We share the concern expressed by others in the System over regulatory agencies which change their public policies without changing their public regulations. Given the prevailing sensitivity of markets and the possibility of marked liquidity pressures in the near-term, we would be hesitant to announce publicly the substance of the Board's memorandum; hence we would be reluctant to undertake a program of the scope outlined in the memorandum on grounds of equitable regulatory practice.

(8) By encouraging banks to restrict lending and avoid liquidating investments, could the Fed reduce upward pressures

on interest rates (thereby relieving the beleaguered Q ceiling and stilling Congressional and other criticism of rising interest rates)?

Whether such a program would indeed relieve upward pressures on interest rates is highly problematical. Larger borrowers, deprived of bank credit, would tend to borrow in the capital markets. To the extent that reduced bank liquidation of securities were offset by an increase in new issues, little downward pressure on rates could be expected. Moreover, a significant reduction in bank credit could have the initial effect of hiking rates if expectations were engendered of severe future credit stringency.

Near-term Liquidity Problems

The second broad objective of the Board's memorandum (as noted previously) is to assure that the banking system will not be affected adversely by mounting liquidity pressures.

In our opinion, the particular problem areas pinpointed by the Board can be dealt with effectively under the present language of Regulation A, particularly under Section 201(d) which states that:

> Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks.

We would stress, however, that member banks even then should make internal adjustments as quickly as possible. Extended discount accommodation to some banks (accompanied by open market operations to prevent a spurt in growth of the reserve base) has the effect of rewarding those banks which have aggressivly expanded loans and liabilities while penalizing the institutions which have behaved more conservatively.

Technical Problems Associated
with the Board's Memorandum

Among other things the memo proposes, in effect, a quid pro quo administrative procedure -- that is, a borrowing bank "shall be considered for greater than usual accommodation" (p.4, para.2) under certain conditions "if, and only if, (it) demonstrates that it is in fact tightening lending policies significantly." (p.5, para.1, italics added) The memo also proposes a daily reporting system by the Reserve Bank on the "banks making use of the additional adjustment assistance credit...in exchange for commitments to their Reserve Banks to adjust their lending policies." (p.8, para.2)

To carry out the specifics of the memo would involve problems of timing, definition, and interpretation.

Timing. Information on loans and investments presently received by the Research Department, processed by the Data Processing Department, and made available to the Discount Department is limited and late. Such information consists of totals only and does not classify loans in any detail. It is received as of two Wednesdays each month and is submitted voluntarily by member banks. Most reports are not received by Research until Friday and Monday following the Wednesday closing. A compilation of this information is not available to Discount until two weeks after the end of a given reserve period, although current data on a given bank may be physically searched out somewhere along the processing line.

Information on federal funds, although submitted daily, is not received from any country bank until at least two business days have elapsed. The Discount Department reviews daily reports submitted by the banks, but this is not until after four or five business days have elapsed. Full details for an entire reserve period are not available until one week after the close of the period. Again data on individual banks are available by search in processing.

Definition. Such terms as "net liquidity, at a reasonable level," "liquid assets," "liquid liabilities," "liquid asset position," "typical bank," "demonstrated judgment of his peers," "tightening lending practices significantly," etc. raise questions of definition that could lead to less rather than more uniformity in administration. Comparative ratios can be developed on a current basis only if information is available on a current basis. The Chicago Reserve Bank prints out in its July "Business Conditions" (p.9) that "There is no statistic that can adequately measure bank liquidity nor is it possible to develop one." Very rough rule-of-thumb ratios can, of course, be obtained, but to apply them to individual bank situations, without much more detailed information, could lead to misjudgment.

Interpretation. We are not sure how one can determine for an individual bank the amount of borrowing under the regular provisions of Regulation A and the suggested provisions of the memorandum. How does one determine whether a bank has tightened lending practices "significantly"? For example, a decline in loans could be seasonal, could result from conditions in the region, etc. Does a slower rate of expansion reflect significant tightening? Also, maybe some banks have tightened up several months ago so that it would be difficult for them to tighten further. The real "purposes" of borrowing often involve a mix of factors, the banker interpreting the "purpose" one way, the discount officer and others interpreting it another. For example, many bankers say the purpose of borrowing is to get reserves to meet Federal Reserve requirements; only time-consuming analyses over time sharpens his awareness of what is really happening or has happened to his funds.

Not only would it be difficult to get data on "commitments" but the idea of "commitment" is extremely difficult to define. "My word is as good as my bond," says the banker. Is this a commitment? "Commitments" range from "All right, come in when you are ready; we will take care of you" to a firm commitment with the borrower paying a commitment fee.

In summary, while the technical problems involved in timing, definition, and interpretation could undoubtedly be worked out, the memorandum proposes an apparatus of borrowing bank and Reserve Bank reporting that may well tend to create inflexibilities in a function, the nature of which calls as much for "feel" and judgment to accomplish objectives as it calls for information.

Moreover, the proposal has two serious weaknesses. It would have no effect on the lending policies of the large number of banks -- member and nonmember -- that do not borrow from the Reserve Banks. It would also discriminate against member banks that do borrow from the Reserve Banks.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Tuesday, Sept. 6

Mr. Martin

These two from Mr. Roosa came in after I talked to you in Bedford Village last Friday.

mnm

from

ROBERT V. ROOSA

Bill -

I'm a real pest!

Bob

BROWN BROTHERS HARRIMAN & CO.
59 WALL STREET
NEW YORK, N. Y. 10005

DOMESTIC SERVICE	
Check the class of service desired; otherwise this message will be sent as a fast telegram	
TELEGRAM	X
DAY LETTER	
NIGHT LETTER	

WESTERN UNION TELEGRAM

W. P. MARSHALL, PRESIDENT

1206 (4-55)

INTERNATIONAL SERVICE	
Check the class of service desired; otherwise the message will be sent at the full rate	
FULL RATE	
LETTER TELEGRAM	
SHORE SHIP	

NO. WDS.-CL. OF SVC.	PD. OR COLL.	CASH NO.	CHARGE TO THE ACCOUNT OF	TIME FILED
			Gen. Expense	

Send the following message, subject to the terms on back hereof, which are hereby agreed to

August 31, 1966

Mr. Joseph Barr
U. S. Treasury
Washington, D. C.

Congratulations on the best statement yet. Call on me if there is any way I can help.

Roosa

DOMESTIC SERVICE	
Check the class of service desired; otherwise this message will be sent as a fast telegram	
TELEGRAM	X
DAY LETTER	
NIGHT LETTER	

$ S E

WESTERN UNION TELEGRAM

W. P. MARSHALL
CHAIRMAN OF THE BOARD

R. W. McFALL
PRESIDENT

INTERNATIONAL SERVICE	
Check the class of service desired; otherwise the message will be sent at the full rate	
FULL RATE	
LETTER TELEGRAM	
SHORE-SHIP	

NO. WDS.-CL. OF SVC.	PD. OR COLL.	CASH NO.	CHARGE TO THE ACCOUNT OF	TIME FILED

Send the following message, subject to the terms on back hereof, which are hereby agreed to

August 31, 1966

THE PRESIDENT
THE WHITE HOUSE
WASHINGTON, D.C.

UNDER SECRETARY BARR TESTIMONY PRIMARILY RESPONSIBLE FOR STRIKING IMPROVEMENT STOCK MARKET TODAY STOP STRONGLY URGE YOU CONFIRM ADMINISTRATION DETERMINATION USE FISCAL MEASURES TO REDUCE NEED FOR ADDITIONAL FEDERAL RESERVE RESTRAINT STOP THIS ONLY EFFECTIVE WAY CHECK RISING INTEREST RATES AND AVOID FINANCIAL PANIC.

ROBERT ROOSA
FORMER TREASURY UNDER SECRETARY.

Chge: Robert Roosa A/C

WU1206(R2-65)

August 31, 1966

Dear Joe,

As you know, I have been most concerned that the present appropriate degree of monetary restraint would be suddenly intensified by a confidence crisis. Such a crisis could be set off either by fears that the Administration was content to allow the Federal Reserve to do the whole job indefinitely, or by fears that the Federal Reserve was being punitively brutal without making delicate provision for the convergence of unusual strains on particular seasonal dates. On Monday, both fears seemed to be getting out of hand. That had a lot to do with the record level of Treasury bill rates and the drastic decline in stock prices.

In this setting it was a real Godsend to have Joe Barr's testimony yesterday. I felt so relieved and hopeful that I immediately dispatched a congratulatory wire to Barr and a supporting wire to the President. I do not send wires very often. Since these are really all in your bailiwick and since I never want to reach out into Treasury affairs without keeping you fully informed, I am enclosing copies of both telegrams--in case you should have a second to look at them.

I am still hoping that there might be some way of enforcing a limit on the market activities of the various Federal credit agencies, and on the volume of asset sales. If that could be done, and accompanied by an announcement indicating that this was deliberately initiated by the Treasury in order to help in the necessary reduction of demand pressures in the credit markets, you would be making a major contribution toward getting us through this period when we need restraint without paralysis. As I said in my wire to Barr, I do want to be helpful if there is any way that I can. It is in that spirit that these telegrams were sent.

All the best,

Sincerely,

ROBERT V. ROOSA

P. S. It has just occurred to me that I ought to send copies of this letter and the attachments to Bill Martin--just to make sure that his inbasket is really chock full when he returns.

The Honorable Henry H. Fowler
Secretary of the Treasury
Main Treasury Building
Washington 25, D. C.

Enclosures

cc: Wm. McC. Martin

from

ROBERT V. ROOSA

Bill –

Thought this should add a bit to your in-basket on return! Best, Bob

BROWN BROTHERS HARRIMAN & CO.
59 WALL STREET
NEW YORK, N. Y. 10005

August 30, 1966

Dear Robbie,

Having just finished the enclosed letter to Ed Dale, in response to his current canvass of "economists", I thought you might possibly also have some interest in my reply. It seems to me terribly important to get across to the markets now, as they flounder in anxiety, a realization that this present strain is a necessary concomitant of getting monetary restraint to become effective all down the line. But I think it is equally important that the Fed, somewhere soon, find a way to make clear that this does not mean an absolute cutoff in the supply of funds but that seasonal requirements will be met in amounts that correspond reasonably with the seasonal patterns of other years. But, the provision of reserves for seasonal requirements, when the markets are already so over-stretched, requires differing techniques than this to which the market has more often been accustomed. This may to a large extent, for example, mean that reserves initially will be edged out through the discount window, and only validated in part later through open market operations. Meanwhile, the banks, having been kept on a string through incurring larger and larger borrowings, will have every motive to hold down the size of individual advances, while also turning down others.

But I certainly do not need to tell you all about this. I am just repeating what in a feeble way I find myself saying to so many in the markets--that the Fed must hold to its present tightness, but this does not mean a credit deadlock or an absolute abandonment in the face of seasonal needs.

With good wishes and warm regards,

Sincerely,

ROBERT V. ROOSA

P.S. I am sending copies of this letter and my letter to Ed Dale to Bill and Dewey, as well, in case they should be interested whenever they return.

The Honorable J. L. Robertson
Board of Governors of the Federal
Reserve System

August 29, 1966

Dear Ed,

My reply to your questionnaire is enclosed but I cannot let it go without a covering letter.

The problem you are struggling with in these various questions is not susceptible to short answers. In the American economic experience now, as I see it, we are really writing a new book--creating the analysis and the methodology for the restraining side of the "new economics." During 1966 we have had to run the experiment without the most powerful tool of the new economics, that is, an appropriately restrictive fiscal policy. The result, because a suitable framework of interacting fiscal and monetary policies has not been possible, has been a breakdown of another essential tool--incomes policy.

Any appraisal of monetary policy, for that reason, has to be conditioned by this sort of preface. It seems to me that our overriding problem in the financial sphere is that the aggregate demand for funds exceeds the aggregate supply of savings plus permissible bank credit. Even though the gap between total demand and total supply may not be wide, all financial markets feel an absolute shortage. They are having to begin to learn to live with tight money. This means that banks and insurance companies and savings and loan associations and others have to learn to question the size of loans as well as making the easier decision as to whether a loan could safely be made.

Under these conditions, many financial institutions have been disturbingly slow in adjusting to the need for more selectivity in the uses of their funds. They have, in the name of competition, gone on lending or investing for too long without seriously initiating arrangements for scaling back or screening their commitments. As a result, their liquidity--and this relates to all kinds of financial institutions, not merely banks--has been depleted or dangerously reduced. It appears that an intense squeeze was necessary in order eventually to force upon many of these institutions a realization of the need to scale down their loans and investments.

By holding down the expansion of bank reserves, instead of feeding all demands with more and more credit, the Federal Reserve has done two things: (1) prevented the present demand inflation from cumulating into a monetary binge with rapidly spiraling prices; and (2) put a number of financial institutions under the kind of intense pressure that we must have in order to close the gap between the aggregate demand for funds and the aggregate supply of them. But there had to be a risk that a few might panic (and possibly even fail in the process) as most take timely action to improve their liquidity and tighten controls over their loans and investment positions.

In effect, unless the Fed allowed demand pressures to create conditions in which there would be a good deal of alarm, the necessary action would not be taken by financial institutions. Without their action, the markets could not edge toward the equilibrium that will provide an answer to the present strain. If the Fed can both keep its nerve and also provide temporary relief whenever the pinch gets dangerously tight, another important lesson will have been learned by all of us. If we get a second chance to prove the capacity of the "new economics" on the high side, particularly if fiscal policy then works in better relationship with monetary policy, there can be a reasonable allocation of scarce funds through the market place without having to reach the extremes of agonized complaints or of high interest rates that certainly characterize the present experience.

You can see from all of this that I do not feel able to give succinct simple answers to your questions. The Treasury, for example, could do much toward relieving the apprehension in the money and capital markets by establishing a tight control over the issuance of new securities by all of the Federal agencies, including the various "asset sales," for the remainder of the autumn period of peak seasonal demands for money. I have strongly urged all of my old colleagues, as well as Charlie Schultz and the C. E. A., to try to limit this miscellaneous array of friction-creating issues to the amounts needed for refunding of their outstanding obligations. If this means a shortfall in Treasury cash, that shortfall can be made up with much less burden on the market through the issuance of additional Treasury bills.

Even if there were no embargo on agency issues for new money, there would be considerable gain in simply being able to tell the markets what to expect, in terms of approximate magnitude and timing. The unknown overhang of perhaps billions of assorted agency issues is an important cause of the present skittishness in the markets. I would hope that in any overall appraisal you would find some place to mention the need for removing this kind of abrasive influence which has certainly been an important cause of the present high interest rates.

Having said all of that, and hopeful that you will have time to read it, I can now give quick answers to your questions.

With good wishes and warm regards,

Sincerely,

ROBERT V. ROOSA

Mr. Edwin Dale, Jr.
New York Times
1701 K Street, N. W.
Washington, D. C. 20006

Enclosure

1. Do you feel any sense of concern, or even alarm, that the current monetary situation may be heading toward a financial crisis of some kind--runs on financial institutions, a liquidity crisis in the banks, etc.? Include a stock market crisis if you think it relevant.

Yes. Strong demands for all kinds of credit and capital, in excess of available savings and bank credit, are creating an over-taxed situation. In combination with new concern over possible run-away wage pressures and deteriorating confidence in the economic generalship of the Administration, these factors are causing the most serious stock market collapse in several years.

2. For that or other reasons, do you believe that the Fed should now start pursuing an easier policy, supplying more reserves to the banks?

The Fed should not adopt a generally easier policy; it should be prepared to provide temporary relief at times when many pressures converge in unusual size

3. Alternatively, in light of monetary policy's failure until very recently to curb expansion of bank credit and the money supply, and in light of continuing inflationary pressure, do you think policy should continue tough or even tougher?

Bank credit and the money supply have been limited to about the right degree. I would continue overall policy just as it is. Bank credit and the money supply will have to expand seasonally over the weeks ahead, but the tightness is at last being sufficiently felt to preclude excessive further expansion.

4. In light of the President's decision not to make significant use of fiscal restraint thus far, do you believe the Fed's policy this year has been: Too restrictive? Not restrictive enough? About right? (Circle the one you believe.)

5. Do you believe there has been over-reliance on monetary policy, with not enough help from fiscal policy?

Monetary policy would not have been placed under so much strain, and interest rates would not have risen so far, if there had been a moderate tax increase early in 1966. Even now, a careful husbanding of borrowing operations by Treasury agencies, combined with indications that the Administration will ask for additional taxes early in 1967, would help greatly.

6. Do you believe that continuance of the present or a tougher degree of monetary restraint will, in and of itself, lead to a recession next year? Alternatively, do you believe the Fed can shift policy when soft spots occur and that a recession induced by the current monetary restraint is not inevitable?

Skillfully exercised, monetary policy can still get the economy through, without leading to recession next year, provided further exacerbation of the strains is not caused by other arms of the Government. There will be no difficulty for the Fed to shift policy if serious soft spots occur in the economy.

Comments:

CLASS OF SERVICE

This is a fast message unless its deferred character is indicated by the proper symbol.

WESTERN UNION TELEGRAM

W. P. MARSHALL
CHAIRMAN OF THE BOARD

R. W. McFALL
PRESIDENT

SYMBOLS

DL = Day Letter
NL = Night Letter
LT = International Letter Telegram

The filing time shown in the date line on domestic telegrams is LOCAL TIME at point of origin. Time of receipt is LOCAL TIME at point of destination

1965 DEC 6 PM 10 50

LLF293 (5)CTA672 B752
M MWB627 PD MILWAUKEE WIS 6 847P CST
WILLIAM MCCHESNEY MARTIN JR
2861 WOODLAND DR NORTHWEST WASHDC
THE REPUBLIC NEEDS MORE MEN WITH YOUR FORESIGHTEDNESS CONGRATULATIONS

DICK TILLEY
(52).

WU SF1201(R2-65)

1965 DEC 6 PM 11 04

C-70112

Mr. Martin

Friday, September 30

Mr. Martin

Your schedule for the weekend.

First I should mention--if I haven't had a chance to do it earlier--that

John Ecklund of Yale called you this morning; his secretary spoke to me ; she said that if you could not get back to Mr. Ecklund by 4:15 today, he might try to reach you at home on Saturday. I told her his letter had been received; she mentioned that they sent a copy of it to your home also.

Friday evening

The dinner with the Mitchells (and the Daanes) is at 7 p.m. at the Cosmos Club--with all to meet in the Ladies Lounge (rather than in the "special" room mentioned in earlier plans. Informal.

Saturday, October 1

8 p.m.. Mr. and Mrs. Clifford Folger's black tie dinner at the 1925 F Street Club--you and Mrs. Martin.

Sunday, October 2

10:15... You and Mrs. Martin are "due" at Mats Terminal for take-off at 10:30 in the Coast Guard plane for the luncheon in Tarrytown.
Mats is located in the north concourse of National Airport--is the turnoff for the North Terminal. Secretary and Mrs. Fowler and Mr. Schweitzer will be going.
The plane is scheduled to arrive at Westchester Airport at 11:40, where you will be met by a Coast Guard car--to take you to Tarrytown by 12.

It is expected that the party will depart about 3:30 (and this time probably means from Tarrytown ; arrival at Mats in Washington will be at about 5:15 p.m.

mnm

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STRICTLY CONFIDENTIAL (FR) July 16, 1968.

TO: Chairman Martin
Governor Robertson
Governor Daane
Mr. Holland
Messrs. Reynolds, Hersey, Wood,
Ghiardi and Bryant
Mr. Dale (IMF)

FROM: Robert Solomon

This paper was prepared at the request of Secretary Fowler. I have sent it to Fred Deming, asking him to pass it on to the Secretary.

12th

Attachment.

Jan.17, 1969

Mr. Martin

Here's some "refresher" material on what you and the Board have said hitherto about the sort of propositions set out in the President's Economic Report.

Think I'll furnish to Board members as information that may be helpful.

Chas. Molony

January 16, 1969.

MEMORANDUM TO BOARD (For information only).

Here is some quick background material on the position of the Board, where any has been taken, on the three Federal Reserve structural "reforms" mentioned in the President's Economic Report, at page 13.

#1--"The term of Chairman. . .should be appropriately geared to that of the President to provide further assurance of harmonious policy coordination."

Replying on September 9, 1968, to questions from Mr. Patman, the Board made the following comment that appears on page 47 of the House Banking Committee's "Compendium on Monetary Policy Guidelines and Federal Reserve Structure," issued in December, 1968:

> In a letter dated October 6, 1966, to Representative Abraham J. Multer, chairman of the Subcommittee on Bank Supervision and Insurance of the House Banking and Currence Committee, Chairman Martin stated that the Board believed that the terms of the Chairman and Vice Chairman of the Board should be related to the President's term of office and that a new President should be able to appoint a Chairman of his own choice and should not be limited in his selection to incumbent Board members.
>
> A change in the law enabling the President to appoint a Chairman of his own choice shortly after his inauguration would provide a practical basis for effective coordination of Federal Reserve monetary policies with the fiscal and financial policies of the executive branch of the Government without affecting the exercise of independent judgment by the Board in the discharge of the responsibilities imposed upon it by Congress. Such an arrangement would in fact afford a means by which the Federal Reserve, through the Chairman of the Board, would be better able to participate, at the highest level of the executive branch, in continuing efforts to promote the sound conduct of the Government's financial affairs.
>
> In order to accomplish the objectives of such a change in the law, any amendment for this purpose should provide for an adjustment in the terms of members of the Board so that the term of one member would expire in each odd year instead of an even year, thereby causing a vacancy to occur in the membership of the Board in the year of a President's inauguration. <u>Any such amendment should also provide for a reasonable time lag, perhaps as much as 6 months, between the time a newly elected President takes office and the expiration of the terms of the incumbent Chairman and Vice Chairman</u> (underscoring supplied).

#2--The President's Economic Report, page 13: "The rigid requirement that no more than a single member of the Federal Reserve Board may be appointed from any one Federal Reserve District should be removed so that the President, with the advice and consent of the Senate, may choose the very best talent for the Board."

At the House Banking Committee's hearings on "The Federal Reserve System After Fifty Years," on January 22, 1964, p. 40, Congressman Bolton questioned Chairman Martin about a part of his statement favoring the dropping from the Federal Reserve Act of "any reference to representation of particular segments of our society." Mr. Bolton continued: "And you indicated there at least to me, that you would also favor dropping the geographical representation of the Board. Would you feel--would you not feel that this would hold the possibility of getting a concentration of members from one particular area of the country only?"

Mr. Martin replied as follows (p. 41 of the hearing record): "Yes; I think it does raise that possibility, Mr. Bolton. But in making that suggestion, having thought about it a great deal, I would assume that any President who was making appointments to the Federal Reserve Board would be very certain in his own mind if he had two men from the same district, that the men were so outstanding that it would overcome that geographic disadvantage. . . .I would think that any President facing up practically to this problem would recognize that he would like to have on the Federal Reserve Board the west coast, the center of the United States, and the East. . . . Sometimes it just happens that on the Pacific coast, which is a very large area, there may be someone in Los Angeles who would be ideal, and there may be someone equally ideal in Seattle. Yet by law now there is no chance of getting those two men, even though their circumstances may be such that they would be available under these conditions, and it would not unduly imbalance the Board to do that.

"I think it is very important that we try to get the highest grade, most capable men we can get. And that is what we are after. . . ."

#3--Economic Report, p. 13: "The Congress should review procedures for selecting the presidents of the 12 Reserve Banks to determine whether these positions should be subject to the same appointive process that applies to other posts with similarly important responsibilities for national policy."

This (as we are telling press inquirers) is a new proposal, and therefore the Board has had no occasion to take a formal position on it.

There have been a number of occasions, of course, when questions have arisen about presidents of the Banks serving on the Open Market Committee. And in connection with that, questions have been asked by Mr. Patman and others about the status of the Reserve Bank presidents. For example, at the January 22, 1964, hearing on "The Federal Reserve System After Fifty Years," Mr. Reuss posed the question (p. 38 of hearings): "Is it not a fact that the presidents of these banks, the men who sit on the Open Market Committee, are in fact the creatures of private power rather than public power?"

Mr. Martin replied: "The initiative on the appointment comes from the board of directors of the individual Reserve banks. But the Congress has given the Federal Reserve Board the authority on the president and first vice president. We can disapprove them. We have complete authority on the president and the first vice president of the banks. So, to that extent, they are public officials.

"Mr. Reuss. What do you mean, complete authority over them?

"Mr. Martin. Well, I am talking about the approval or disapproval of them. When the name comes up to the Board--the seven members of the Federal Reserve Board--there is no participation by the board of the individual bank.

"Mr. Reuss. Yes. But you cannot appoint a president who is not appointed by the majority of private bankers on the board of the particular Reserve bank, can you?

"Mr. Martin. We certainly have a good bit of influence. If the chairman and deputy chairman are in disagreement with the other six board members, you have a situation that is not likely to be tolerated.

"The point I am trying to make, Mr. Reuss, is that this is a very ingenious blending of public and private activity. . . ."

Subsequently, in an interchange with former Governor Balderston, Mr. Reuss denied that the implication of the questions he asked is that the presidents of the 12 Reserve banks are captives of the banking industry. The interchange continued as follows (p. 39-40):

"Mr. Reuss. I am simply saying that they are not the appointed servants of the people of the United States of America, because they are not appointed by the public appointing authority, as you members of the Board are.

"Mr. Balderston. But I would like to point out that when they come to the Open Market Committee, the five who are serving for that particular year take an oath of office, which makes them public servants for that period of time.

"Mr. Reuss. They are public servants in whose selection the President of the United States and other U. S. authorities played no part, except the very remote, indirect role that Chairman Martin has described.

"Mr. Balderston. Which is a very direct role. Seven members of the Board play a very significant part and very direct role in the selection of those presidents. And as to whether they represent themselves and vote in accordance with their own consciences, or at the behest of private bankers, I would like to suggest that you ask the bankers in any one of the districts whether the president of their Federal Reserve bank obeys their suggestions and intimations as to what they would like. It would be an interesting survey."

Charles Molony

-0-