William McChesney Martin, Jr., Papers

Box 20/Folder 12

Series V, Subseries A

FRB Open Market Committee, 1955-1956

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK 45, N.Y.

RECTOR 2-5700

May 12, 1955

Personal and Confidential

Hon. Wm. McC. Martin, Jr.
Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

Dear Bill:

As requested, I am sending you herewith a copy of the notes which I used, including the proposal I placed on the table, at the meeting of our Special Committee on the Organization of the System Open Market Account. My objective, in this proposal, is to try to avoid unnecessary changes in the existing organization while, at the same time, taking cognizance of the dissatisfaction expressed by some members of the Federal Open Market Committee concerning the method of selection of the Manager of the System Open Market Account and the lines of authority and responsibility between the Federal Open Market Committee and the Manager.

At our meeting I suggested that the present organization of the Account is the result of a process of evolution, and that its virtues should not be abandoned because of its defects or its lack of complete logic, unless we can be sure, or reasonably sure, that whatever might be substituted for it would not have greater defects, some of which could only become apparent over time. Those who set up the present organization, and it was mainly the work of competent draftsmen at the Board of Governors, were aware of the history of development of open market operations, and tried to fit the new organization and procedures into that line of development, having in mind the requirements of the law, as amended, which also attempted to build on what had gone before. The law, I have always thought, contemplated institutional (Federal Reserve Bank) responsibility for operations in the open market as distinguished from Federal Open Market Committee responsibility for open market policy, and this is consistent with other important organizational arrangements within our regional Federal Reserve System.

If it is believed that the climate of opinion has changed to such an extent as to require adjustments in our open market organization which depart from this thesis, we may well have to consider seeking confirmation of this belief by legislative action.

Yours Faithfully,

Allan Sproul

Enclosure

P.S. On Tuesday, May 24, I am already scheduled to attend a meeting of the Committee on the History of the Federal Reserve System at Brookings Institution at 12:45 o'clock p.m. This will mean that I shall not be available for meeting of our special committee until, say, 3 o'clock that afternoon.

A.S.

Special Committee
F.O.M.C. 5/10/55
AS

Confidential

Have tried to set down our terms of reference, growing out of the debate at the meeting of the Federal Open Market Committee on March 2, 1955 with some comments of my own along the way.

1. (a) As a matter of formal status the Manager of the System Open Market Account to be made more directly responsible to the Open Market Committee as a whole.

(b) Special committee to bring back concrete proposals for perfecting structural and operating organization that will best implement policies of FOMC.

(c) Conclusion by special committee that no change should be made in present relationship definitely would be outside its terms of reference. Anyone who voted for the motion setting up the special committee voted with that understanding.

(d) Whatever recommendation the special committee makes will be presented for consideration of the full committee which may revise, accept or reject the recommendation.

(e) Sponsor of motion setting up special committee might be persuaded before full committee is through, that it is not feasible to get a better arrangement, but wanted to register his dissatisfaction with the present arrangement. If full committee decides we don't want to make any changes, we shall at least have studied the problem carefully and have decided on the basis of such study to retain the status quo.

2. Special committee is therefore charged with bringing before the full committee one or more alternates to present structural arrangements and operating organization of the FOMC. Those who voted for the resolution setting up the special committee are, at this stage, committed to the finding that present arrangements are unsatisfactory. Those who voted against the resolution are not committed to this finding, but are charged with seeing if something better than the present arrangements can be devised.

3. We are all charged with the knowledge, as brought out in the presentation of the motion setting up the special committee, that there are no personalities involved in this matter, that change is not dictated nor suggested by political considerations or political pressures, and that the situs of the account's operations is not involved.

4. The defects of present arrangements, as claimed in the debate which resulted in the appointment of the special committee, are

   (a) The FOMC has a basic and positive responsibility for the selection of individuals who administer the System Open Market Account. Our present arrangements do not permit us to discharge that responsibility adequately.

   (b) The Manager of the Account should not be reporting to the Board of Directors of the New York bank either directly or through the President of the New York bank. (He doesn't report to the directors of the New York bank, either directly or indirectly, on open market operations other than to present figures of past transactions, as published, and get approval of

If so makes a farce out of whole procedure! —

New York bank's execution of these transactions and participation in them.)

(c) Not considered proper that Manager of the Account, because he is also Vice President of the New York bank should be in a position where he might have to resist pressure to report operations that directors of the bank may wish him to report. (This is a hypothetical problem, which does not exist in fact. Directors of Federal Reserve Bank, in accepting designation of New York bank as Federal Reserve Bank charged with executing transactions for FOMC, also accepted prohibition against their receiving or seeking to receive other than published information on operations of System Open Market Account.)

How is this prohibition determined. Is it signed? or formal.

(d) Don't want operational responsibility limited to the New York bank or to Manager of the Account. The whole committee must be really responsible. (I would submit that you can't have twelve managers of the Account - at some point and in some way the policy-making body has to transmit operational authority to an executive, institutional or individual or both.)

no question of operations delegated authority not unusual and control so over personnel

(e) Relationship of Manager of Account to the Chairman of the FOMC.

(1) If someone had wanted to expose me as Chairman, as being responsible for operations and ideas I did not believe in, it would have been perfectly possible for him to do so when I first came over here. (But is that not the position of any member of the FOMC at times? It has been the position of the Vice Chairman of the Committee for a good many months past. We must remember that we are a committee made up of twelve individuals and that the Chairman is only first among equals.

We operate on the basis of the decisions of the majority of the Committee.)

(2) Personally, the Chairman did not feel he could order the Manager of the System Open Market Account, even in a minor way, without going through the President of the New York bank first. (But that is a matter not of persons nor of individuals, but of institutional responsibility versus individual or personal responsibility, which I stressed in the committee discussions. The committee can order the Federal Reserve Bank of New York and the Manager of the Account to carry out open market operations in any legal way it wishes. But certainly executive authority over the Manager of the Account cannot be exercised by each of twelve members of the FOMC acting individually, and to transfer such authority to the Chairman of the committee would be going much further than the transfer of authority to an executive committee which has been and is now under question.)

Employee first meeting Personal vanity on my part.

(3) What would be the position of the Chairman of the FOMC if the individual selected to manage the System Open Market Account proved to be a cantankerous individual who wanted to build an empire for himself as Vice President of the Federal Reserve Bank of New York. (Well, I presume his position would be that he would take up the matter with the FOMC and proceed to get rid of the Manager. Which brings up the next point.)

(4) Even though the by-laws of the Committee state that the Manager of the System Open Market Account serves at the pleasure of the Committee, the fact is that the Committee does not have that discretion, except in very special circumstances, because of the way in which the Manager of the Account is selected by the New York bank, subject only to the approval of the FOMC. (Which brings us back to the first point of the indictment, that present arrangements do not permit the individual members of the FOMC to discharge adequately their basic and positive responsibility for the selection of the Manager of the Account.)

(5) As I see it, that is the only point of substance. It would seem to me that this special committee should have placed before it various ways for selecting the Manager of the Account and, as a matter of formal status, making him more directly responsible to the FOMC. Its members should then have time to study these various methods and to compare them with the present method, and one with another. It should also have a meeting with the directors of the New York bank to ascertain what their views may be since any change from the present method would affect the New York bank. Then the special committee should meet again to discuss the various methods it has considered and to see if it could agree on one as being preferable for recommendation to the FOMC.

(6) For my part, while reserving the right to advocate the retention of the present organization when we go back to the full committee, and without committing the New York bank, because

I have not discussed this with my directors, I want to throw something like the following into the hopper:

(a) Prior to each annual reappointment of the present Manager of the Account, a meeting of member representatives of the FOMC and the Board of Directors of the New York bank be held to discuss the appointment, so that a process of joint consultation before appointment will be established.

(b) If and when it becomes necessary to appoint a new Manager of the Account, a list of possible appointees containing the suggestions of members of the FOMC and of the Board of Directors of the New York bank to be prepared and their qualifications studied by member representatives of the FOMC and the Board of Directors of the New York bank. Those who survive this preliminary examination of qualifications would then be interviewed by the joint committee.

Why if they are not reported to and have no policy responsibility

(c) The joint committee would be charged with agreement on a candidate, who would then be named Manager of the Account, by the Federal Reserve Bank of New York as the bank chosen to execute transactions for the System Open Market Account, subject to the approval of the FOMC.

(d) There would be reaffirmation of the provision of the by-laws of the Committee that the Manager of the Account serves at the pleasure of the Committee, which with the change in method of selection, would remove whatever basis there is for feeling that the Committee does not in fact retain that power.

(e) Such an arrangement would preserve the desirable ingredient of institutional responsibility for execution of policy, which is an ingrained part of the Federal Reserve System, and would avoid the probable necessity of seeking legislation to make more radical changes in present practice. At the same time, it would make the Manager of the Account more directly responsible to the FOMC and would improve the structural and operating organization of the Committee.

CONFIDENTIAL (FR) June 6, 1955

Memorandum:

To Members of Federal Open Market Committee Special Committee

Subject: Management of the System Open Market Account

From J. L. Robertson

The Federal Reserve Act empowers the Federal Open Market Committee to "adopt ... regulations relating to the open-market transactions" of the Federal Reserve Banks, and requires the Reserve Banks to participate in open market operations "in accordance with the direction of and regulations adopted by the Committee".

In view of the broad discretion thus conferred, the Committee lawfully could prescribe for the System Open Market Account almost any organizational or "housekeeping" pattern that was not patently unreasonable or capricious. However, our present consideration of practical alternatives seems to have narrowed to three:

1. The Committee could have its policies executed through a separate Open Market Committee managerial staff, having no other functions, located in Washington.

2. The Committee could have its policies executed through a Manager of the System Open Market Account, appointed by and responsible solely to the Open Market Committee, but located in a Federal Reserve Bank designated from time to time by the Committee.

3. The Committee could continue the present arrangement of having the Manager be an officer of the Federal Reserve

Bank of New York, but the annual appointment of the Manager would be handled through a joint committee of members of the FOMC and directors of the Federal Reserve Bank of New York.

As I see it, the first of these alternatives would establish most definitely (short of new legislation) the "independence" of the Committee's operations and their divorcement from the operations of any particular Reserve Bank. The second alternative is that suggested in Mr. Martin's memorandum of May 10, 1955. The third is the possibility mentioned in Mr. Sproul's memorandum of the same date.

1. Separate Open Market Committee staff located in Washington. "If we had a clean sheet of paper to write upon", as President Wilson said, this alternative might have greater appeal. The majority of the Committee have their offices in Washington, and the presence of the Manager (whose position might be merged with that of the Committee's Secretary) and his immediate staff in Washington would encourage those members to have frequent direct contacts with the Manager, thereby enhancing their understanding of day-to-day operations and the staff's understanding of the Committee's policies. It is probable that such close and continuous contact between a majority of the Committee and the Managerial staff would increase the effectiveness of the Committee in its performance of one of the Reserve System's most important functions and would result in the System Account's transactions reflecting more precisely the Committee's current policies and objectives.

It might also be contended that the existence of a separate Open Market Committee staff and the location of that staff in Washington would make for more "detached" Account operations. Washington is not a great money center and the thinking of the staff inevitably would be based more upon objective economic facts and less upon the "feel" of the market, which is bound to exercise greater force when the staff is located in a great money market and is in frequent contact with the people who constitute the market. In other words, by shifting to Washington all Open Market Committee operations except the mechanical performance of market transactions, we could minimize the possible influence of people other than members of the Committee and its staff.

There are cogent arguments against this alternative, however. In the first place, management of the System Account always has been centered in New York City. Against this historical background, a shift of location to Washington might be interpreted as indicating a lack of confidence in the New York Reserve Bank's handling of this work, which is not the case. Such public misunderstanding might be detrimental in more ways than one, and should be avoided unless the counterbalancing benefits are very clear.

An even stronger argument against the Washington-staff proposal is simply a denial of the contention that the Committee's operations necessarily are most effective when based solely on "objective" statistical data. It is plausibly contended by some that, although the making of monetary policy calls for detachment from day-to-day market influences, central-bank operations can achieve maximum effectiveness and minimum disturbance only if they are conducted on the basis of first-hand and up-to-the-minute knowledge of current happenings in the nation's chief money market. Washington is certainly not the best place in which to obtain such last-minute knowledge and "feel"; without doubt the prime location for this purpose today is New York City, which is still our principal money market.

2. Separate Manager of the System Open Market Account located in a designated Reserve Bank. It seems to me that this is the nub of the changes suggested by Mr. Martin. Its objective would be to secure the benefits of an operating Manager concerned solely with execution of FOMC policies, while avoiding the disadvantages, previously mentioned, of a shift of physical location to Washington. If this alternative is adopted, the Committee's decision presumably would be couched in terms of location "in a Federal Reserve Bank to be designated from time to time by the Committee". For the foreseeable future, probably, the designated bank would be the Federal Reserve Bank of New York, but the suggested form of resolution might have psychological value by enhancing the sense of the FOMC staff that it is not a part of a particular Federal Reserve Bank, but is only physically situated there, for convenience, and at the pleasure of the Committee. To some extent, our purpose would be to give to the Manager and members of his staff a relationship comparable to that

of the District Chief National Bank Examiners who maintain their office in Reserve Bank buildings, for reasons of efficiency and convenience, without being considered in any sense a part of the Reserve Banks.

In my view, the chief value of Mr. Martin's proposal is that it will tend to increase the likelihood that, in all circumstances, the management of the System Open Market Account will reflect precisely and exclusively the policies of the Committee. But to take full advantage of such organizational changes, the Committee must be determined - and must carry out its determination - that directives to the Manager will be more definite and absolute than has been the case generally in the past. It might well require more frequent meetings of the Committee, as a result of which relatively narrow ranges of operations would be prescribed. Under this procedure, the Manager's functions might consist of observing the market and economic factors generally, preparing economic information and views for submission to the Committee, and devising mechanics and techniques of orders to the Open Market Desk of the designated Federal Reserve Bank which will effectively carry out the specific directives of the Committee.

As an illustration, let us assume, putting aside other standards and criteria for the moment, that the Committee in September 1955 decides to maintain a free-reserve level of $100 million to $200 million. At that time, free reserves happen to be in the neighborhood of $240 million. In these circumstances, the Manager would act as promptly as possible without undue market disturbance to sell some $50 million of bills (or perhaps $40 million or $60 million); in other words, ordinarily the Manager would take the minimum action necessary to bring the situation within the limits prescribed by the Committee but would keep the Committee informed of changes in economic environment or trends which might warrant a change in the instructions.

Necessarily, the Manager would also act promptly to offset other factors affecting the level of free reserves, such as money in circulation, Treasury deposits, float, and gold movements, but such action would be taken only when one or more of those factors resulted in a level of free reserves which was above or below the prescribed range. For example, in the situation outlined above, no action by the Manager would be called for by a subsequent increase of $70 million in money in circulation (other factors not changing), since the resulting level of free reserves - approximately $120 million - would still be within the range contemplated by the Committee's current directive.

To sum up the foregoing, it seems to me that a decision by the Committee to maintain closer contact with the management of the Open Market Account may be no more than a matter of form unless it is coupled with a regular practice of making that contact effective through directives which are definite and quantitative as well as philosophical and qualitative.

3. <u>Continuation of present arrangements, except that Manager would be appointed through joint action of the Committee and the New York Reserve Bank</u>. This appears to be the essence of Mr. Sproul's suggestion. To the extent that it gives the Committee a more effective voice in the selection and reappointment of the Manager and staff, it is a move in the direction deemed advisable by a majority of the Committee. However, it seems an unnecessarily limited effectuation of the principle that the management of the Open Market Account should be responsible solely to the Committee. To the extent that any Reserve Bank, as such, participates in the selection of the Manager, divided responsibility necessarily results, particularly because the Manager and his staff would be physically located in, and immediately compensated by, the Reserve Bank which had a measure of control over their tenure and perquisites.

In brief, my reaction is that Mr. Sproul's idea does not go far enough in a direction of carrying out the Committee's objective in this respect, which is to have an Open Market managerial staff that looks only to the Committee for control and approval, provided that this objective can be attained without loss of the practical benefits of the present arrangement and without creating any erroneous impression of intra-System conflict or Committee dissatisfaction with the manner in which the Committee policies have been carried out in the past. (In this connection, I should perhaps mention my understanding that the Federal Reserve Bank of New York, through its trading desk, presumably would continue to be the agency through which actual open market transactions would take place. The relationship between the New York Bank's trading desk and the Open Market Account Manager would be comparable to the relationship of the desk and the Treasury Department in connection with Treasury open market transactions.)

Allocation of salaries and expenses. I do not feel any importance should be attached to the immediate source of the compensation of the Manager and his staff. It is difficult to believe that a man of the caliber required for this position would be affected by the circumstance that his salary checks were drawn by a certain Reserve Bank or by the Board of Governors, particularly since he would know that the ultimate source of his compensation would be the Reserve System generally, via proration among the Reserve Banks.

However, in the event the Committee feels this phase of the matter is not negligible, it will be recalled that the Committee's General Counsel is of the opinion that the Board of Governors could employ persons needed for the Committee's staff at salaries specified by the Committee; accordingly, this procedure appears to be available if the Committee concludes that technical "employment" of the Manager by the Board is preferable to his employment by a particular Reserve Bank.

Conclusion. It appears to me that, having due regard to the history and present status of the System's Open Market procedures, changes along the lines submitted by Mr. Martin are best calculated to achieve our objectives in this area, provided the Committee effectively utilizes the new arrangement by providing the Account Manager with more definite (and probably more frequent) directives than has been our practice in the past.

This should be an apologia

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK 45, N.Y.

RECTOR 2-5700

Personal and Confidential

June 8, 1955

Hon. Wm. McC. Martin, Jr., Chairman,
Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

Dear Bill:

Enclosed are my notes for the meeting of the Special Committee of the Federal Open Market Committee held on June 6, 1955, which I was asked to send to the members of the Committee.

It seems to me that the deliberations of the Special Committee would be furthered if the alleged defects of the present arrangements with respect to the conduct of open market operations, directed by the Federal Open Market Committee, could be set down in black and white in some orderly manner and distributed among the members of the Committee prior to its next meeting. We could then reexamine these alleged defects and compare them with the possible defects of alternative proposals, none of which, it can be assumed, will be perfect. So far, most of what we have concerning the alleged defects of the present structural arrangements are scattered statements made in oral discussion.

I also think it would be helpful to the Committee to have the benefit of counsel's consideration of the problem of employment of a Manager of the System Open Market Account by the Federal Open Market Committee. It has been my understanding that it is the opinion of counsel that there would be certain practical difficulties attendant upon trying to change present arrangements without legislation, that the matter is open to some troublesome questions, and that the most clean cut method and the only method that would be certain of avoiding various practical difficulties would be to obtain legislation. If the problems with which we are struggling are as important as has been suggested, and if understanding of our procedures by the Congress and by the public is one objective of the proposed changes, a clean cut method of effecting these changes would seem to be desirable. And yet, I would assume, that no one of us wishes to go before the Congress on a matter of this sort at this time if it can be avoided.

Yours faithfully,

Allan Sproul

P.S. I suppose that the preparation of such a list of alleged defects of present arrangements, as I have suggested, would fall naturally to you since it was largely upon your insistence that the present Special Committee was appointed and given its assignment. A.S.

Special Committee, FOMC
6/6/55
AS

Confidential

1. In terms of the proposal presented by the Chairman at our last meeting ("Status of Manager of System Open Market Account" - May 10, 1955) what we are now discussing is vastly more important than the form of appointment of the Manager of the System Open Market Account, or his status vis-a-vis the Federal Open Market Committee. We are now involved in the whole problem of the purpose and functioning of the arm of the Federal Reserve System in the principal national and international money market of the country. Perhaps this was inevitable in our assignment, although it goes well beyond what was discussed when that assignment was given to us. In any case, it demands the greatest objectivity, the least personal bias, and the most thorough study we are able to give to it. It is in that way that I have tried to analyze the proposal of the Chairman. Briefly I don't think it would work well, and I don't think it would be desirable from the standpoint of the Federal Reserve System, the Federal Open Market Committee or the Federal Reserve Bank of New York.

2. The analogy. Suggested that what is now proposed is somewhat comparable to the Chairman of the Board and Federal Reserve Agent of pre-1935.

(a) Office of the Chairman of the Board and Federal Reserve Agent was a statutory one and there was provision in the statute for method of fixing his compensation. Proposed office of Manager of System Open Market Account not provided by statute and there is real question as to whether statute intended Federal Open Market Committee, which was derived from earlier forms of open market committees, to have a paid staff and to direct, in this way, the detailed operations of Federal Reserve Banks in the open market. There is pretty clearly a question about payment of the salary of the Manager of the Account as proposed. The statute provides a specific method of payment of compensation by Federal Reserve Banks to directors, officers, and employees, and the proposed Manager and his staff would be none of these. Under the proposal the Federal Reserve Bank of New York would be drawing its check to pay salaries and expenses to be determined by another body, without legislative sanction.

(b) The old style Chairman of the Board and Federal Reserve Agent, as a director of the Bank, had statutory responsibilities relating to the administration of the Bank and its affairs, quite apart from his responsibilities to the Board as Federal Reserve Agent. There was an attempt to tie him into both the Board and the Bank. The present proposal attempts to avoid this straddle, but it would be inherent in the situation created. In many if not all cases the original arrangement with respect to the Chairman of the Board and Federal Reserve Agent was a continuing source of friction and administrative difficulty at the Federal Reserve Banks, at least until one man had assumed the dominant position, whatever the ambiguities of the law.

(c) In my judgment what has been suggested with respect to the Manager of theSystem Open Market Account cannot find a happy forerunner in the old arrangement with respect to the Chairman of the Board and Federal Reserve Agent, but the comparison does point to the sources of administrative and operational friction which are the likely outcome of such arrangements, and raises a real question as to whether legislative action would be necessary to accomplish what is suggested.

3. So much for the analogy. Now to concentrate on the substance of the proposal. In my opinion it has three fundamental and overlapping weaknesses. One is its substitution of individual responsibility for institutional responsibility. The second is its attempt to separate and segregate open market operations directed by the Federal Open Market Committee, from all other forms of central banking operations in the central money market of the country. The third is the impetus it would give to administrative friction, and the obstacles it would place in the way of executive recruitment, training and development.

4. In the discussion of this problem which took place at the meeting of the Federal Open Market Committee in March, I expressed certain views on institutional versus personal responsibility and I need not repeat them here. The present proposal tries to retain some semblance of institutional responsibility. It aims to make use of the necessary facilities of the Federal Reserve Bank of New York, but to shift operational direction of part of those facilities into the hands of a separate Manager of the System Open Market Account. This is not the kind of institutional responsibility I have talked about and which I think is an integral part of our regional reserve system. To preserve the kind of institutional responsibility I think is necessary, the directives of the Federal Open Market Committee and its Executive Committee should run to the Federal Reserve Bank of New York, as they do now, and the Federal Reserve Bank as an institution must be responsible for carrying out those policy directives; not merely responsible for the mechanics of transactions directed by an outside Manager of the System Open Market Account. The latter arrangement shifts the main burden of responsibility from an institution to an individual.

5. The deeper but related defect of the proposal lies in its narrow definition of the functions of the Manager of the System Open Market Account and in its attempt to separate his operations from the operations now performed by the Federal Reserve Bank of New York, as the Federal Reserve Bank representing the System in the principal money market of the country. The money market is not a collection of water-tight compartments which can be separated in this way, and the responsibilities of the System in the money market are no less resistant to such separation. The System's

responsibilities in that market are all inter-related. They include, among other things, not only open market operations for System Open Market Account, but loans made by the New York Reserve Bank to money market banks, the analysis and careful monitoring of the reserve position of the money market banks, the consultative handling of Treasury depositary arrangements, the substantial transactions funneled through the New York Bank for investment accounts of the Treasury, and the large operations undertaken for the account of foreign central banks and governments. These are a principal part of the complex of forces which, as they affect the flow of funds into and out of the banking system, and the residual settlement of reserve needs at the money center, have to be administered consistently with one another and with the policy directives of the Federal Open Market Committee, if the central banking system is to do its job. The operations of the Federal Reserve Bank of New York which are not under the direction of the Federal Open Market Committee cannot arbitrarily be separated from the open market operations which are directed by the Federal Open Market Committee, without serious loss of effectiveness. To cite but one example our operations for System Account (outright purchases and sales) totaled $4,257 million in 1954 and our operations in Government securities for others (purchases and sales) totaled $3,895 million. All of these operations need unified direction.

It is not too much to say, in fact, that the new proposal would threaten to destroy the coordination of money market instruments that has evolved over the past forty years, and been used by the Federal Reserve Bank of New York, as an institution acting for the whole Federal Reserve System, both in fulfilling the System's responsibilities in the money market, and in accordance with the general directives of the Federal Open Market Committee. To be most effective the coordination must be centered in the institution, and in men working as a team within the institution, so that without loss of motion, or the need to pass through separate channels of authority, all or any of the several instruments available to the Bank, in any of itscapacities, can be brought to bear on the problem.

The common use of one trading desk for the mechanics of open market operations, as proposed, and assuming as we must the best will in the world on both sides, would still not achieve maximum coordination of operating decisions made by two separate entities having authority in two separate areas. This would seem to be an obvious lesson of administrative experience. Nor could relations with all of the various factors in the market be maintained on a coordinated basis if there were dual controls at the Federal Reserve Bank. It would be possible under present arrangements, of course, to indicate to dealers the origin of orders which we place with them, but I question whether even this is desirable as a matter of central banking practice and whether we would be justified in giving such information to individual dealers when it is not available to the whole market.

A stated reason for the suggestions contained in the proposal is to eliminate an "anomalous situation". I should say that the proposed arrangement would create a more anomalous situation and one less easily explainable to the Congress or to the public than what we now have.

6. I need not say much about the third weakness of the proposal. I have already mentioned it - the tendency to administrative friction and the weakening of executive recruitment, training and development. In my opinion, it would probably create an unsustainable administrative situation and would certainly be charged with a high friction potential. You may say the present operational structure has that also, but it is the product of long historical evolution. We have learned to live with it, and it shouldn't be put aside in the interest of a new scheme whose defects we can only imagine, particularly if our real objectives can be achieved in some other way.

On the matter of recruitment, training and development, we would have two lesser jobs taking the place of one key job. Lesser men, over the years, would be attracted to these jobs. One of the jobs, that of Manager of the System Open Market Account, would be outside the regular orbit of System organization and operation, a bob-tailed thirteenth Federal Reserve Bank. As has happened often in the past, there might be long periods when the System Account would be inactive, when the Manager of the Account would lose that touch with the whole money market (not just the Government securities market) which can come only from participating in actual transactions, and when the making of studies and writing of reports would not be enough to maintain interest and keep faculties sharp. Similar difficulties would face the small staff of a separate Manager; lack of sufficient continuity, breadth and scope of operations to insure suitable recruitment, training and development, because of an invisible wall between the Manager and his staff and the staff of the Federal Reserve Bank of New York.

The possibility of adequate high level coverage also enters here. That coverage needs to have depth, to take account of administrative requirements and vicissitudes of health. Under the present institutional arrangement the Manager of the Account is backed up by the President of the Bank who is a member of the Federal Open Market Committee, the First Vice President who is an alternate member of the Federal Open Market Committee, as well as by the Manager's own subordinate staff. A separate Manager would have only a small subordinate staff, presumably of lesser caliber than the Manager himself, and high level coverage in depth through an institutional chain of command would be lacking.

7. Would not be so free to condemn what has been suggested in this proposal, if I did not think real objectives of the Federal Open Market Committee could be attained in other ways.

The matters of concern which seemed to underlie the discussion of the Federal Open Market Committee at its March meeting were:

(a) The method of appointment of the man who serves, in effect, as chief operating officer of the Committee in carrying out the institutional responsibilities assigned to the Federal Reserve Bank of New York by the Committee.

(b) The fact that expenses relating to open market operations carried out under direction of the Committee are not reviewed by the Committee before they are incurred, and are not clearly anddirectly shared by all of the Federal Reserve Banks, with the possible implication that he who pays the piper may call the tune.

(c) The place of the Federal Reserve Bank of New York in the Federal Reserve System. Whether or not the assignment to the bank of responsibility for the open market operations directed by the Committee, along with all of its other duties and responsibilities, doesn't upset the balance among national and regional representation in policy formation which is essential for good central banking in this country.

To try to remove or allay these concerns, which have grown, at least in part, out of past shortcomings, I suggest an extension of the tentative proposals I submitted at our last meeting.

8. (a) Prior to each annual reappointment of the present Manager of the Account, the Assistant Vice President and the two Managers of the Securities function of the Federal Reserve Bank of New York, a meeting of member representatives of the Federal Open Market Committee and the Board of Directors of the Federal Reserve Bank of New York be held to discuss the appointments so that a process of joint consultation, before appointment by the Bank and approval by the Committee, would be established while retaining the institutional responsibility of the Federal Reserve Bank of New York.

appointment by the Comm. and approval by Bank

(b) If and when it becomes necessary to appoint a new Manager of the Account, a list of possible appointees containing the suggestions of members of the Federal Open Market Committee and of the Board of Directors of the Federal Reserve Bank of New York would be prepared and their qualifications studied by member representatives of the Federal Open Market Committee and the Board of Directors of the New York Bank. Those who survive the preliminary examination of qualifications would be interviewed by the joint committee. This committee would be charged with agreement on a candidate who would then be named Manager of the Account by the Federal Reserve Bank of New York subject to the approval of the Federal Open Market Committee.

(c) Whenever it is proposed to make changes in the incumbents now serving as Assistant Vice President, and as Managers in the Securities function of the Federal Reserve Bank of New York, the changes could be discussed with the member representatives of the Federal Open Market Committee on the joint committee before actual transfers are made.

(d) There could be reaffirmation of the provision of the by-laws of the Federal Open Market Committee that the Manager of the Account serves at the pleasure of the Committee which, with the change in the method of selection, should remove whatever basis there is for feeling that the Committee does not in fact retain that power if needed. If the power were exercised, the tenure of the principal assistants of the Manager, of course, would come up for review.

(e) In accepting the designation of the Federal Open Market Committee as the Federal Reserve Bank selected to execute transactions for System Open Market Account, and in assuming the end responsibility for the appointment of the Manager of the System Open Market Account, subject to the approval of the Federal Open Market Committee, the directors of the Federal Reserve Bank of New York would continue to commit themselves (as they have in the minutes of the Bank in the past) to the understanding that the Manager of the Account would not be expected to and should not report to them on operations of the Account, other than to present the facts and figures of past transactions, which are regularly published, such transactions to be ratified and approved.

9. Budget and Allocation of Expenses

(a) At the same time that the total budget of the Federal Reserve Bank of New York is prepared, a separate budget relating to open market operations to be carried out under the direction of the Federal Open Market Committee would be prepared and sent to the members of the Federal Open Market Committee for their review and suggestions. As submitted, or later revised, this budget would, of course, be part of the total budget of the bank which is finally passed upon by the Board of Governors.

(b) The expense of operations carried out for the Federal Open Market Committee under the budget would be allocated among the twelve Federal Reserve Banks, at appropriate intervals and in accordance with an acceptable formula of allocation such as has been used in connection with other System matters.

(c) A statement of performance under the budget including comparison of expenditures with estimates - would be submitted to each member of the Federal Open Market Committee after the end of the year.

10. The position of the New York Bank in the Federal Reserve System has always been a matter of some political suspicion and some internal friction, beginning with the steps leading up to the establishment of the System and the establishment of district boundaries, and continuing up to the present day. It appears to be an inescapable fact growing out of the economic and political geography of the country, as well as out of the structure of the System. There will probably always be a problem of keeping Washington, New York, and the rest of the System in properly balanced relationship. We might as well face it. But both analysis and experience should teach us that the problem can't be solved by one-shot cures. And we shouldn't attempt to solve it by chipping away the powers of the Federal Reserve Bank of New York and weakening its ability to do its job as an arm of the Federal Reserve System, without, at the same time, adding to the total powers of the System or strengthening its capacity for effective performance of its duties. The answer, which will probably never be complete, lies rather in an attempt by all concerned to study continuously and discuss fully the policy implications of action which may be contemplated or taken under changing economic conditions. In the area of those open market operations which are under the direction of the Federal Open Market Committee, the steps which the Federal Reserve Bank of New York has recently taken to improve the character and quality of its reports to the Committee, and the suggestions which it has made for further improvement of communications between the Management of the Account and the Committee, seem to me to indicate the direction to be followed in ameliorating this problem.

I cannot accept the assumption that the change which the Chairman's proposal suggests inthe structure of our open market arrangements would not have serious repercussions on the position of the Federal Reserve Bank of New York. I believe that it would cast doubt on the performance of the Federal Reserve Bank of New York, a doubt which some in the market have sought to create and exploit for their own reasons. And by casting doubt on the performance of the New York Bank we run a serious risk of damaging the prestige of the whole Federal Reserve System. This is a hazard which should be risked, if there is warrant for charging the New York Bank with failure to meet its responsibilities. This charge has not beenmade. The hazard could be risked, I suppose, if there were no other way of meeting the concern of some members of the Federal Open Market Committee with present arrangements. In my opinion, however, whatever real basis there is for concern about these arrangements can be met by the adjustments which I have suggested.

11. To summarize

(a) The experience of the Federal Reserve System with a full-time Chairman of the Board and Federal Reserve Agent does not recommend the adoption of similar arrangements with respect to the Manager of the System Open Market Account and his immediate staff. It led to administrative difficulties, internal friction, and the eventual dominance of one side of the dual monarchy over the other. In addition, the adoption of a similar arrangement with respect to the Manager of the System Open Market Account and his immediate staff, as proposed, would seem to require legislation, if "practical difficulties" and "troublesome questions" are to be avoided.

(b) In essence, even though not in appearance, the proposal would substitute individual responsibility for institutional responsibility in an operational matter. Institutional responsibility is a part of the fabric of our Federal central banking system, with its division of most powers between policy making bodies at the center and operational units at the regional Federal Reserve Banks.

(c) The proposed segregation of duties of the Manager of the Account and the Vice President of the Federal Reserve Bank of New York in charge of its Securities function would be an attempt to divide something which, in terms of central bank operation in the principal national and international money market of the country, is inseparable. There are two aspects to the principal task of the Federal Reserve Bank operating in this money market.

One aspect of the job is to keep the money market functioning smoothly from day to day and week to week so that temporary flows of funds into and out of the market, from whatever cause, will not tie knots in the market and cause trouble for the whole economy. The other aspect of the job is the more dramatic one of influencing the general trend of bank reserves and money market conditions in accordance with the overall policies adopted by the Federal Open Market Committee which are, in turn, part of the general credit policy of the whole Federal Reserve System, whether that be ease, neutrality or restraint in all of their various manifestations.

These two aspects of one task involve, at various times, the discount window, transactions for Treasury accounts, the consultative timing of Treasury calls on depositaries, transactions for foreign governments or central banks, and transactions for international accounts, all of which should be fitted in with transactions executed for the Federal Open Market Committee. The key individual part in discharging this responsibility of the central banking system of the country, in New York, is played by the Vice President in charge of the Securities function of the Federal Reserve Bank of New York. The institutional responsibility is that of the Federal Reserve Bank of New York acting in behalf of the Federal Reserve System. It is claiming a great deal for cooperation and coordination to insist that the job could be done better under the proposed division of responsibility between an institution and an individual. The operations of the Federal

Reserve Bank, wholly as Bank, are inextricably tied in, it seems to me, with the special open market operations directed by the Federal Open Market Committee which are now executed by the Bank. To try to separate them, and to try to operate them under two heads, cannot help but lead to a loss of effectiveness and efficiency of our whole central banking mechanism.

(d) The separation of one key job into two lesser jobs, over time, would attract lesser men, and the division of responsibility and authority between two men would create more internal administrative and operational friction than we now have. The separation of the Manager of the System Open Market Account from the Federal Reserve Bank of New York would also weaken the senior coverage in depth which can now be provided for transactions undertaken for System Open Market Account.

Conclusion: It is not necessary to create these hazards, run these risks, whittle down the position of the Federal Reserve Bank of New York, nor weaken the effective functioning of our regional central banking system, in order to relieve the real concern of those within the System who have doubts about our present arrangements, and to rebut the attacks of those outside the System who, for political, or other reasons have been trying to create a schism between Washington and New York - between New York and the rest of the country.

FEDERAL RESERVE BANK OF RICHMOND

RICHMOND 13, VIRGINIA

June 8, 1955

PERSONAL AND CONFIDENTIAL

The Honorable Wm. McC. Martin, Jr.
Board of Governors
of the Federal Reserve System
Washington 25, D. C.

Dear Bill:

In accordance with the suggestion made at the meeting of the Special Committee on Monday, I enclose a copy of the notes I used at the meeting.

Sincerely yours,

Hugh

Hugh Leach

June 4, 1955
HL

Notes Prepared for Use at the Meeting of the Special Committee of the Federal Open Market Committee at Washington on June 6, 1955

The existing organization of the Open Market Committee appears awkward but it has worked well in practice. Our assignment is to devise a more logical type of organization which will function in a way comparable to the existing organization. Particular attention is to be given to the formal status of the Manager of the Account with a view to making him more directly responsible to the Open Market Committee as a whole.

As I see it, the key point is institutional versus individual responsibility for operations in the open market. Should the directives of the Executive Committee be addressed to the Federal Reserve Bank of New York or to the Manager of the Account? In this connection it should be remembered that it is never practicable to draw a fine line between policy and operations. At the moment, I see no convincing case for the retention of institutional responsibility for operations as a principle and I believe it could be abandoned without legislation. I would not, however, suggest amendment or modification of existing institutional responsibility unless some other type of equally efficient organization can be devised. Changes in relationships between the Open Market Committee and the Federal Reserve Bank of New York and the financial community should be held to a minimum.

Chairman Martin has presented a plan under which directives of the Executive Committee would be addressed to the Manager of the Account rather than to the Federal Reserve Bank of New York. This would place primary responsibility for operations upon an individual rather than an institution. In other respects the proposal would apparently keep the New York bank "in the picture" as much as practicable. In Item 6 of the Chairman's plan it is stated, "The Manager would, of course, report to the Vice Chairman of the Federal Open

Market Committee as well as to the Chairman and other members." It is clearly impracticable for the Manager to maintain continuous contact with all twelve members of the Open Market Committee, and it is my understanding, drawn from Chairman Martin's comments at the first meeting of the Special Committee, that there is no intention to change the present practice under which the Manager is in continuous consultation with the Vice Chairman of the Open Market Committee with respect both to interpretation of instructions and conduct of operations. To me, it is important that this be understood.

Two provisions, or sets of provisions, in the Chairman's plan merit careful study by the Special Committee --

(a) Both the Manager of the Account and the Trading Desk would maintain contacts with dealers. How would this work in practice? Would the dealers and money market banks talk freely with both? Would the Manager of the Account have the "feel" of the market as he now does? Who would discuss with the Treasury the timing of calls on tax and loan accounts? How would purchases and sales by the Federal Reserve Bank of New York for the Treasury, foreign central banks, and member banks be coordinated with open market purchases and sales? Who would keep in close contact with the money desks of the money market banks? Some of these questions are more important than others, and there are probably other pertinent questions that have not been mentioned.

(b) The plan contemplates full cooperation on the part of the Federal Reserve Bank of New York in supplying technical, financial, and economic data to the Manager of the Account. Would this present serious problems to the New York bank?

For one who lives in Richmond it is difficult to answer satisfactorily the questions listed above or to appraise the probable reaction of the financial community to the Chairman's plan without first obtaining the views of the President and directors of the Federal Reserve Bank of New York.

Mr. Sproul's letter of May 12, 1955 and his memorandum dated May 10, 1955 have been read with interest. His proposal that the Manager be appointed by a joint committee of the Open Market Committee and the directors of the Federal Reserve Bank of New York would make the Manager more directly responsible to the Committee, but I think the Special Committee should attempt to develop alternative recommendations.

The Special Committee has an important assignment, and, as previously indicated, I should like to have the views of the New York bank on the questions listed under (a) and (b) above before arriving at any definite conclusions.

Regardless of any other changes which may be proposed, I think it would be desirable for all expenses incurred in open market operations to be shared by the twelve Reserve banks.

FEDERAL RESERVE BANK
OF DALLAS

WATROUS H. IRONS
PRESIDENT

June 13, 1955

Mr. Wm. McC. Martin, Jr.
Special Committee of the
Federal Open Market Committee
Board of Governors of the
Federal Reserve System
Washington, D. C.

Dear Bill:

In accordance with our understanding at the meeting on June 6, 1955 of the special committee of the Federal Open Market Committee, I am enclosing a memorandum reflecting the statement which I made at that meeting.

As my statement indicates, it is a tentative position, because I feel that there may be important operating problems and possibly legal problems - although I do not feel so strongly on the latter point - which the committee has not resolved as of this time. I suppose such tasks as those will become the next order of business of the committee.

With cordial regards.

Sincerely yours,

Bob

Watrous H. Irons

Confidential Memorandum   June 13, 1955

To: Special Committee of
    Federal Open Market Committee

From: Watrous H. Irons WHI

Subject: Summary of statement - June 6, 1955 - on Status of Manager of the Open Market Account

My tentative inclination with respect to the status and responsibility of the Manager of the System Open Market Account is toward the proposal submitted by Chairman Martin on May 10, 1955, but with certain modifications and one major reservation. The basic problem facing us seems to resolve itself into a decision to accept - with possible modifying amendments - one or another of the three broad alternatives which have been suggested in Governor Robertson's statement of June 6, 1955. At this time my thinking is toward his second or middle-course approach, which involves the proposal outlined in Chairman Martin's memorandum referred to above.

Chairman Martin's proposal would place the selection of the Manager and the Assistant Manager of the Open Market Account, and such subordinates as seem desirable, solely with the Federal Open Market Committee. The Manager would serve at the pleasure of the Committee at a salary fixed by the Committee, and would concern himself solely with the work of the Committee; his staff would also serve at salaries fixed by the Open Market Committee and would concern themselves solely with the work of the Committee. The Account would be located in the Federal Reserve Bank of New York.

Chairman Martin's recommendation raises certain questions in my mind. While I believe, on the basis of my present legal understanding, that the Open Market Committee could directly select a Manager and his subordinates, making them solely responsible to the Committee, I have serious doubts regarding the desirability of building up an additional and entirely separate staff outside of the Reserve banks and the Board of Governors. At this point in the special committee's discussion, I do not object to the Committee appointing the Manager and Assistant Manager of the Account or to the proposal that those persons shall be solely responsible to the Federal Open Market Committee. I also believe it should be possible administratively for the Account to be operated in the New York Federal Reserve Bank and the Manager of the Account be responsible to the Open Market Committee rather than the New York Federal Reserve Bank. In my judgment, the Account certainly should be located in the Federal Reserve Bank of New York. I believe, however, that the Manager and the Assistant Manager of the Account should be serviced by the existing technical, operating, and research staffs of the New York Federal Reserve Bank, the other Federal Reserve Banks to the extent desired, and the Board of Governors. Therefore, in addition to those provisions of Chairman Martin's recommendations listed under "Action by the Federal Reserve Bank of New York" I would add the following items:

(1) To provide the Account with the necessary technical operating staff and facilities to enable the Manager of the Account to conduct the Account's operations on a day-to-day basis. Furthermore, the Federal Reserve Bank of New York, the other Federal Reserve Banks and the Board of Governors should cooperate fully with the Manager in supplying such technical financial, and economic data as may be needed by him in the

discharge of his responsibilities to the Federal Open Market Committee.

(2) To maintain for the Account records of transactions affecting the Account, and other records that may be required in connection with the operations of the Account.

To utilize further the existing technical and research staffs of the System, I think it would be desirable for the associate economists of the Federal Open Market Committee to report biweekly their impressions of the economic situation and its implications for credit policy to the economist of the Federal Open Market Committee, so that these reports, together with any other information available to him might be used in the preparation of a report which he would submit biweekly to the members of the Federal Open Market Committee. The Manager of the Account, with the approval of the Chairman of the Open Market Committee, should have the authority to call upon the research department of the Board of Governors or of any Federal Reserve Bank for such reports, studies, and other economic information as he may deem necessary.

A second modification or clarification that I would recommend in Chairman Martin's proposal relates to the day-to-day contact of the Manager of the Account with members of the Federal Open Market Committee. It seems to me that any proposal should clearly state the lines of contact, for there would surely be many occasions when the Manager of the Account would feel it necessary to have immediate, informal contact and discussion with appropriate members of the Committee. The Manager would not be in a position to consult with the officers and directors of the Federal Reserve

Bank of New York as such, because of his responsibility directly and solely to the Federal Open Market Committee. Two alternatives might be considered in connection with this problem.

(1) Between meetings of the Federal Open Market Committee (which, in my judgment, should be monthly or more frequently if necessary) the Manager should maintain contacts - daily or as frequently as he may consider necessary - with the Chairman and/or Vice Chairman of the Open Market Committee, and, in unusual circumstances, with such other members of the Committee as he may deem compelling, (or alternatively) -

(2) With an Executive Committee of the Federal Open Market Committee, composed of the Chairman and the Vice Chairman of the Open Market Committee, and the Vice Chairman of the Board of Governors.

I believe that some such more or less definite lines of contact must be spelled out in order to avoid confusion and misunderstanding.

It is also recommended in Chairman Martin's proposal that the Manager of the Account would concern himself solely with open market matters and that there would be, in addition, a vice president of the Federal Reserve Bank of New York who would have charge of fiscal agency operations, foreign agency operations, the securities department, the trading desk, and other functions which are now assigned to the officer who is the Manager of the System Account.

I am particularly impressed with the statement presented in Mr. Sproul's memorandum of June 6, 1955 relating to this problem.

Operations in the money market "outside" of the Account are very substantial and obviously exercise an influence upon conditions in the market. To separate these two major substantial groups of operations without meeting the problem in some way by coordination of action to obtain a desired unified result might well lead to serious difficulties. At the moment I see considerable danger in a system that would involve two more or less uncoordinated lines of approach to the money market involving very substantial sums. This particular feature of Chairman Martin's proposal involves my major reservation.

In summary, at this stage and subject to modification of views as a result of further discussions and consideration, I would tentatively support Chairman Martin's proposal provided ways could be found (1) to avoid the creation of an additional technical, operating, research staff solely associated with and responsible to the Open Market Account and, in a sense, outside of the Federal Reserve banks and the Board of Governors; (2) that a satisfactory direct day-to-day line of contact could be worked out between the Manager of the Account and the appropriate officials or members of the Open Market Committee; and (3) that the problem of two major and vitally important approaches to the money market could be reconciled and coordinated in such a way as to assure the maximum possibility of achieving at any time the desired unified effect and objective in the money market.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 1, 1955

To Chairman Martin

Subject:

From Mr. Riefler WR

CONFIDENTIAL (FR)

Attached is a copy of the preliminary draft of the minutes of the meeting of the Federal Open Market Committee held on June 22, 1955. It will be appreciated if you will review the draft and advise not later than Thursday, July 7, whether you have any changes to suggest.

The minutes of the meeting of the Federal Open Market Committee held on May 10 were approved in the form sent to you on May 23. The minutes for the meeting of the executive committee held on June 6 were approved in the form sent to you on June 20, 1955.

Attachment

PRELIMINARY DRAFT

CONFIDENTIAL (FR)

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Wednesday, June 22, 1955, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Balderston
Mr. Earhart
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Vardaman

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, Rice, Roelse, Wheeler, and R. A. Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Koch, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Securities Department, Federal Reserve Bank of New York

Messrs. Erickson, Johns, Powell, and C. S. Young, Alternate Members of the Federal Open Market Committee

Messrs. Williams, Bryan, and Leedy, Presidents of the Federal Reserve Banks of Philadelphia, Atlanta, and Kansas City, respectively.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 10, 1955, were approved.

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee held on May 10, May 24, and June 6, 1955, were approved, ratified, and confirmed.

Before this meeting there had been sent to the members of the Committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period May 10 to June 15, 1955, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed June 16-21, 1955. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse noted that the only change reflected in the supplementary report distributed at this meeting was a reduction of $2,351,000 in the amount of acceptances held by the Federal Reserve Bank of New York under the existing authorization of the Committee. Mr. Rouse said that he felt the market was aware of the fact that there would be a substantial contraction in the volume of reserves between now and the end of this month. There would, however, be some addition to funds in the market as a result of maturing tax anticipation notes.

In connection with the forthcoming Treasury financing, Mr. Rouse said that there was considerable discussion in the market as to where the reserves which would be necessary to support the financing would come from and whether such reserves would be provided "freely" or "reluctantly". Another topic being discussed, he said, was the current administration of the discount function at the Federal Reserve Banks, there being considerable gossip to the effect that the discount window was "practically closed, a la 1953". Mr. Rouse stated that while this was gossip, he felt it should be reported to the Committee since the comments persisted.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period May 10 to June 21, 1955, inclusive, were approved, ratified, and confirmed.

Chairman Martin referred to the suggestion that he had made at the meeting on March 2, 1955 that consideration be given to abolishing the executive committee of the Federal Open Market Committee and that the matter be placed on the agenda for discussion at this meeting. He went on to say that his thinking had not changed very much since March, that he considered the Open Market Committee to be the heart and core of the Federal Reserve System, and that the experience of the last few months gave further indication of the desirability of having the full Open Market Committee take the responsibility for decisions not only of policy but also as to open market operations. It was Chairman Martin's view that there was merit in abolishing the executive committee. He recognized, however, that there might be another side to the question, and he wanted to be sure that adequate time was given for consideration of the question, especially if any of the members of the Committee or other Federal Reserve Bank Presidents had doubts as to the desirability of such action.

Chairman Martin then referred to the letter distributed by the Secretary under date of May 10, 1955, which transmitted a draft of proposed action of the Federal Open Market Committee abolishing the executive committee, prepared by Mr. Vest, and he requested that Mr. Vest outline the changes that would be necessary in the event the executive committee were abolished.

Mr. Vest made a statement in which he said that if the Federal Open Market Committee should determine to abolish the executive committee it would seem necessary to make certain changes in (1) its Regulation relating to Open Market Operations of Federal Reserve Banks, as amended June 19, 1952; (2) the Rules on Organization and Information of the Federal Open Market Committee, adopted effective September 11, 1946; (3) the Rules on Procedure of the Federal Open Market Committee, adopted September 11, 1946, and (4) the by-laws of the Federal Open Market Committee, as amended March 1, 1952. It would also seem desirable, Mr. Vest said, that the Committee take action to adopt as its own actions and authorizations any currently effective actions and authorizations of the executive committee now outstanding, and he called attention particularly to the draft of proposed action which had been distributed to the members of the Committee on May 10, 1955.

Mr. Vest further stated that if the executive committee should be abolished there should be a directive from the full Committee to the Federal Reserve Bank of New York providing the same authority as was now provided through the directives of the full Committee to the executive committee and of the executive committee to the New York Bank. In commenting on such a directive, Mr. Vest stated that he had prepared a draft which was substantially the same as the existing directive from the executive committee to the New York Bank but which would omit the existing clause (c) of the full Committee's directive to the executive committee, which clause provided that the executive committee should arrange for transactions with a view, among other things, "to correcting a disorderly situation in the Government securities market". Mr. Vest explained that the reason for omitting that clause from the draft of directive from the full Committee to the New York Bank was because, under the terms of the action of the full Committee at its meeting on March 4, 1953, intervention to correct a disorderly situation in the Government securities market could be initiated only upon the affirmative vote of the executive committee after the existence of a situation seeming to require correction had come to its attention through notice from the Manager of the Account or otherwise -- even though it was recognized at that meeting that, in the event of an emergency such as an international crisis, it might not be possible to canvass all members of the executive committee before initiating such intervention. It was Mr. Vest's thought that, in view of this existing policy of the Federal Open Market Committee, it would not be appropriate to include in the directive to the New York Bank as agent an instruction to arrange for transactions with a view to correcting a disorderly situation in the Government securities market.

Mr. Vest stated that if the executive committee were to be abolished, it would be in accord with the spirit of the Administrative Procedure Act and desirable to publish in the Federal Register appropriate notices of the changes in the Rules on Organization and Information and in the Rules on Procedure, which had been published in the Federal Register in 1946, as well as to publish the Regulation Relating to Open Market Operations of the Federal Reserve Banks, as revised.

Chairman Martin said that in the event the executive committee were to be abolished his thought was that meetings of the Open Market Committee in the future generally should be held at intervals of three weeks instead of two weeks, as had been the case with meetings of the executive committee during recent years.

Mr. Sproul stated that he assumed there was no substantial legal question involved in the proposal to abolish the executive committee. The executive committee has been legally constituted and could be legally continued, which meant that the Committee was left with the question whether to continue the executive committee as a matter of administrative appropriateness, efficiency, and convenience. Mr. Sproul then made a statement substantially as follows:

I am overlooking - or at least disregarding - the reiterated charge of Congressman Patman that Congress gave this great power of directing open market operations of the Federal Reserve Banks to twelve men, the twelve men gave it to five, the five gave it to one, and it ended up in the hands of Wall Street. I continue to cling to the belief that we shouldn't change our organizational structure in order to try to accommodate ourselves to the attacks of the Congressman.

Now, under present arrangements, with members of the full Committee who are not members of the executive committee invited to attend meetings of the executive committee, we have been having what are in effect meetings of the full Committee every two weeks. This has proved to be possible and desirable and it might be said to clinch the argument that our present command over time and space makes the executive committee no longer necessary. Nevertheless, I think there is something to be said for keeping an executive committee in being as an administrative technique, even though our bi-weekly meetings (or our meetings every three weeks as suggested) become meetings of the full Committee in name as well as in fact, and the executive committee meets only on call. There may be times when it will be desirable to have a properly constituted body which can be assembled in a matter of hours, not to make policy but to refine policy made by the full Committee on its way to the management of the Account, as in case of disorderly markets. And there may be emergency situations in which such a properly constituted body would be in a position to make policy, temporarily, in behalf of the full Committee on something better than an ad hoc basis.

It has been suggested, I know, that such situations can be met, when necessary, by a few telephone calls, but I have never had much confidence in this method of reaching committee decisions except on routine matters. When something more than routine consent is the business at hand, a telephone canvass is no substitute for a face-to-face meeting at which ideas can be developed and debated, and the reaction of your associates to those ideas can be observed and taken into account. A telephone canvass depends too much on who asks the question and how he asks it.

I am left with the feeling - and it is no more than that - that we would be giving up something we may want or need if we abolish the executive committee. I would prefer to have our present biweekly meetings (or meetings every three weeks) of the executive committee changed into meetings of the full Committee, but to have the executive committee kept in being, for possible use in special circumstances to sort out issues as between top policy and spot policy, and in emergency conditions temporarily to make top policy. In other words, I do not think we have to abolish the executive committee in order to try to make sure that the full Committee accepts and discharges its responsibilities under the law, and there may be occasions when those responsibilities can be better discharged if an executive committee is kept in existence.

If the executive committee is abolished, we should certainly have in mind the continuance of such meetings as this, at least four times a year, when all parts of the System are brought together to discuss matters of broad policy and important operations. And there should be better preparation for these meetings, in terms of a carefully prepared agenda and necessary background documents available well in advance, and more time allowed for deliberation and discussion, even though we take one or two days to it, instead of half a day.

Mr. Leach said that, as a member of the full Committee and of the executive committee since March 1 of this year, he had been impressed by the fact that almost all members of the full Committee had attended each of the meetings of the executive committee held during the past three months. On the basis of this experience, it seemed to him practicable to have meetings of the full Committee frequently, and he had come to the conclusion that there was no real need for an executive committee. If the executive committee were abolished, Mr. Leach felt that, as Mr. Sproul had suggested, there should continue to be at least four major meetings of the Federal Open Market Committee a year at approximately quarterly intervals at which all of the Presidents of the Reserve Banks would be present when policy matters could be fully discussed. He also suggested that attendance of voting members at meetings of the Open Market Committee scheduled at more frequent intervals, such as every three weeks as suggested by Chairman Martin, might be aided if the groups of three Federal Reserve Banks (such as the Boston, Philadelphia, and Richmond Banks) were to elect two alternate members, instead of only one as is now provided.

Mr. Leedy said there was only one phase of the proposal that gave him concern. This was the question whether abolishment of the executive committee would mean that the Presidents who served in rotation but who were not currently members of the Committee might be placed further out of touch with the work of the Committee than has been the case in the past. If the practice were continued of having four meetings a year of the type now held, at which policy matters were fully discussed, the proposed change might have no effect. However, if policy actions might be taken at each of the meetings suggested at three week intervals, and if the Reserve Bank

Presidents not serving on the Committee were not to be given an opportunity to participate in these meetings, Mr. Leedy's concern was that some Presidents would not be kept as closely in touch with the work of the Committee as they would like to be and as they ought to be.

Chairman Martin said that Mr. Leedy's question came as a surprise since it had never occurred to him that the quarterly meetings of the type held in the past at which all of the Presidents were in attendance would be abolished. Nor had it entered his mind that any President would not feel welcome to attend any meetings of the Federal Open Market Committee that might be held in the future, if he wished to do so and felt that he could do so. His proposal, the Chairman said, was intended to give everybody more participation rather than less participation than they might have had in the past in all the decisions of the Open Market Committee. He did not have in mind abolishing in any way the responsibilities of the Open Market Committee or the responsibilities or participation of any of the persons connected with it.

Mr. Leedy responded that he was glad to hear Chairman Martin's statement, adding that he was not opposed to the proposal to abolish the executive committee and that his concern had been that the Presidents not serving on the Committee have an opportunity to be in attendance at meetings where major matters of policy might be considered.

Mr. Balderston said that on at least one occasion during the past spring he felt the executive committee did not take the action that was indicated at the time simply because it was inhibited from doing so--it did not have the power of the full Committee. He had the feeling, he said, that had the full Committee been meeting the timing of Committee actions might have been better than it was. Mr. Balderston said that he was concerned about being too late and about not acting on time. He was very strongly in favor of Chairman Martin's suggestion that the executive committee be abolished and of Mr. Sproul's proposal that the thorough-going quarterly reviews of the economic and credit situation and of policy and operating matters be continued at the time of the meetings of the Conference of Presidents.

Mr. Robertson said that he felt the executive committee was no longer needed in view of improved communication and transportation facilities. The holding of frequent meetings of the full Committee would in no way detract from the need for continuing the thorough-going quarterly reviews of the situation when all Reserve Bank Presidents were in Washington, since it would be impossible to expect that all Reserve Bank Presidents could attend all Open Market meetings held at three week intervals. Mr. Robertson also suggested that the point mentioned by Mr. Leedy might be covered by providing specifically that all Presidents of the Federal Reserve Banks should be present at meetings of the Open Market Committee.

Mr. Vardaman stated reasons why he felt it was desirable to abolish the executive committee, including particularly the fact that he believed such action would bring the Reserve Bank Presidents closer to the consideration of open market matters and make them more available for consideration of such matters. Mr. Vardaman also said that he was sympathetic to Mr. Leach's suggestion that all Reserve Bank Presidents not currently members of the Committee be elected to serve as alternate members.

Mr. Johns said that he had much the same feeling as that expressed by Mr. Leedy. Under present procedure, when he was a member of the Committee he considered that he was expected to attend all quarterly meetings of the Committee and he did not let anything take precedence over that obligation. This was different, he felt, from merely being "welcome" or "invited" to be present if he wished to be. If he were expected to be here, he would be here every three weeks; but he would like to have a more specific and definite understanding than was indicated by Chairman Martin's suggestion that all Presidents would be "welcomed" at the meetings.

Chairman Martin said that there was the statutory problem: there were only twelve who could vote on open market matters. He did not see how the Committee could compel others to attend the meetings. It could invite but could not "expect" the others to attend frequent meetings if they had no vote. Thus, a President who was not actually a statutory member of the Committee should not feel under compulsion to attend the meetings, and he noted that the President-members had alternates so that the Committee could have a full representation even when some of the President-members could not attend. It was important, he said, that each voting member be present at each meeting if possible or that he be represented by his alternate.

Mr. Johns commented that those who were not members of the Committee had been called upon to vote and required to vote on a matter before the Committee and, in response to Chairman Martin's query, he said he referred to the Chairman's request at the meeting held on March 2, 1955, that all Reserve Bank Presidents vote on the question of a study to review the structural and operating organization of the Federal Open Market Committee. The vote of the non-members was not a legally binding vote, Mr. Johns said, but they had been requested and expected to vote on the proposed study.

Chairman Martin said that when he made the request to which Mr. Johns referred, he did not have any objection to any of the Presidents not voting if they preferred not to do so. However, he then thought the proposal was of such importance that each President should have an opportunity to express himself if he cared to do so.

Mr. Earhart said he was in favor of abolishing the executive committee and having the meetings as needed of the full Committee. He could see, however, that at times some of the President-members might find it very difficult to be present at meetings held every three weeks, and he raised the question as to the procedure to be followed in ascertaining whether the alternate for the President could attend.

Mr. Riefler explained the existing procedure under which all Committee members were advised in advance of meetings and if any indicated they would be unable to attend, the Secretary promptly communicated with the alternate to ascertain whether he could attend. Later in the meeting, Mr. Earhart noted that under the by-laws whenever any member of the Committee representing Federal Reserve Banks shall find that he will be unable to attend a meeting of the Committee, he shall promptly notify his alternate and the Secretary of the Committee in writing or by telegram, and upon receipt of such notice the alternate shall advise the Secretary whether he will attend such meeting.

Mr. Williams stated that the difficulties foreseen in adopting Chairman Martin's proposal seemed to him to be inherent in any change. Under the circumstances, he thought there ought to be some experimentation with the proposal.

Mr. Balderston said that he thought the best answer to the question raised by Mr. Leedy and Mr. Johns was that the Presidents were wanted at the meetings of the Federal Open Market Committee if their arrangements in their individual districts permitted them to attend; they need not feel compelled to attend, but they should feel that they were useful and that it was desired that they attend if they could do so.

Mr. Sproul said that he thought the question went beyond the point discussed. In the past, there has been an organization which has met when all the Presidents were present in Washington and at which meetings there had been major discussions of the economic and credit situation and of policy and operating matters. Out of these discussions, the whole System moved as a body. Under the existing proposal, it would now be possible (although it was not a likelihood) that less than the whole System would make major moves of policy. In the situation which Mr. Balderston had described when he felt the executive committee had failed to act because it was inhibited, he had indicated that had all twelve members of the Open Market Committee been present, a major change of policy might have been made without the other Federal Reserve Bank Presidents participating in its consideration or knowing that it was being considered. Mr. Sproul felt that the difficulty could be overcome if, whenever consideration was to be given to any major change in policy, all Reserve Bank Presidents were advised of the meeting and arrangements were made for them to be present without regard to other commitments they might have.

Chairman Martin said it was apparent that the quarterly meetings of the type held in the past should not be abolished. However, there were still only twelve votes and there could be only twelve votes on policy at those quarterly meetings. Everything possible should be done to broaden the responsibility and the participation of all of the Presidents in these discussions. It was not always possible to say in advance when a major change in policy might be considered, however, and

Chairman Martin suggested that there was a responsibility on each individual President and on each member of the Board of Governors to keep himself sufficiently current with the situation and with the possible need for changes that might arise so that each individual might sense when a major policy question was likely to come up.

Mr. Johns suggested that a President might think he was keeping himself informed but he might not, as an individual, see the necessity for taking an action which another person would have in mind. In order to keep abreast of developments, Mr. Johns felt it would be necessary, in his case at least, to be present at every meeting in order to know when changing conditions might call for consideration of major policy changes.

Chairman Martin agreed with Mr. Johns and added the comment that this responsibility devolved upon each President and each member of the Board of Governors.

Mr. Robertson suggested that in the future the Secretary of the Committee inform each Reserve Bank President as well as each member of the Board of Governors as fully as possible in advance of each meeting of all matters that might come up for consideration.

Chairman Martin stated that he felt it important for all members of the Board and all Reserve Bank Presidents to be more abreast than they have been at times in the past of developments which might affect policy. This was the objective and purpose of his suggestion for abolishing the executive committee. There were cases in which Congressmen and others felt that "islands of responsibility" developed in the System, not only at the New York Bank but at other places. Chairman Martin said that in his judgment there had been some validity to some of these criticisms, and there had been some cases in which "islands" had developed in the System. This was a problem which should be kept before the Board and all Reserve Banks. There also had been times, he said, when he felt that not all of the Board members or the Presidents had participated in discussions of System matters to the extent that would be desirable. This could be improved. It was Chairman Martin's belief that everything possible should be done to improve the understanding and participation of all parts of the System in carrying out its responsibilities.

Mr. Sproul said that he agreed wholly with the objective stated by Chairman Martin. If there have been "islands" in the System, they have not been due to organization, however, but due to concentration of interests, or to the zeal which some had shown for participation in this heart and core of the System to which the Chairman had referred.

Mr. Mills said that the discussion this morning indicated a little hesitation among the Presidents of the Federal Reserve Banks on whether the proposed abolition of the executive committee would accomplish the objective which Chairman Martin had in mind of promoting the concept of the Federal Reserve through the broadest possible participation in problems that arise within the System. This was largely because of the difficulty which the Presidents would have in attending all meetings of the full Committee which would be scheduled at approximately three week intervals. If this was a correct assumption, Mr. Mills said, there had already been much progress made through having meetings of the executive committee at two week intervals to which alternate members of the executive committee were invited. Under this arrangement the quarterly meetings of the full Committee with all of the Reserve Bank Presidents in attendance allowed full discussion of policy matters. Mr. Mills noted that Mr. Vest had indicated that if the executive committee were abolished it would be necessary to publish a statement regarding that change in the Federal Register--a change in the administrative program which might or might not be lasting. Mr. Williams had pointed out that the plan would be experimental, and Mr. Mills raised the question whether the experiment could be accomplished within the present framework of the Open Market Committee's organization. If Open Market meetings were held at intervals of three weeks and all Presidents were invited to attend and found it possible to attend, the executive committee would be abolished as a de facto procedure but not de jure. The proposal could be experimented with without eliminating the executive committee entirely, and Mr. Mills said that he had in mind the difficulties that might arise in the event of an emergency and the development of a disorderly market where a decision to act to correct such a situation had to be made by the Committee. In such an event, the smaller the group necessary for making such a decision, the more likely that the decision could be reached promptly and the necessary corrective action brought to bear. If the executive committee were thus retained in the manner suggested by Mr. Mills, the decision as to correcting a disorderly market situation could be allowed to remain in the executive committee.

Chairman Martin said he had given a great deal of consideration to the question Mr. Mills raised. It seemed to him that the Committee had been experimenting in various ways for two or more years, trying to get more participation on the part of those connected with the operation. He did not believe any purpose would be served by continuing on an ad hoc basis without facing up to the question of the Committee's problems. Chairman Martin referred to the responsibilities of the Federal Reserve System.

stating that he felt these responsibilities just the same as other Board members and Presidents do and that he believed the best procedure was to get all of those problems before the group. There had been discussions as to whether individuals were welcome at the desk at the New York Bank and whether they were welcome to attend meetings here at the Board if they were not statutory members of the Open Market Committee. His view was that the time had come to make a decision and not to engage in halfway measures. He wanted to see whether there was some way of eliminating some of the difficulties that had shown up in the past. Chairman Martin said that Mr. Mills was correct in feeling that some of the Presidents expressed concern regarding his proposal for abolishing the executive committee, but he personally had no concern. He felt this course should be followed not only on a de facto basis but as a matter of recognized change. Mr. Sproul had indicated the view quite sincerely that the structure of the organization was working on a sound basis, and Chairman Martin said he recognized Mr. Sproul might be correct in this view. However, his own feeling was that the present structure had difficulties which the Committee should try to eliminate.

Mr. Johns said that he would not wish to be misunderstood. He was not reluctant to come to a meeting of the Federal Open Market Committee every three weeks and he would not feel unwelcome to attend such meetings even though not a statutory member of the Committee, if

Chairman Martin's proposal were to be adopted. He wished to make it clear that if the proposal was adopted he would plan to attend all meetings that were called, unless something uncontrollable intervened to prevent his attending. Mr. Johns went on to say, in response to a question from Mr. Robertson, that he had obtained a fully satisfactory answer to the question he had posed earlier this morning.

Mr. Robertson suggested that it would be desirable to give all Reserve Bank Presidents an opportunity to express themselves on the matter.

Chairman Martin stated that he would be glad to have this procedure followed with the understanding that if any of those who were not members of the Committee did not care to express views on the proposal, they need not feel called upon to do so. He then asked for expressions of opinion on the proposal to abolish the executive committee, and all of the members of the Committee who were present as well as the Reserve Bank Presidents indicated that they would favor the proposed action, except that Mr. Mills stated that he would do so with reluctance, and Mr. Bryan stated that he would prefer not to express a view although he would not wish to be understood as indicating opposition to the proposal.

Thereupon, upon motion duly made and seconded, the Federal Open Market Committee approved by unanimous vote the following actions:

(1) That the Regulation of the Federal Open Market Committee relating to Open Market Operations of the Federal Reserve Banks, as amended effective June 19, 1952, is hereby further amended effective immediately as follows: (i) by striking out all of subsection (e) of section 2 of such regulation and all of section 5 thereof, and (ii) by appropriately renumbering subsequent sections of the regulation.

(2) That the Rules on Organization and Information of the Federal Open Market Committee adopted effective September 11, 1946, are hereby amended effective immediately as follows: (i) by striking out all of section 3 of such rules and by appropriately renumbering the subsequent sections thereof, and (ii) by striking out the words "or its Executive Committee " in the first sentence of subsection (c) of the existing section 6 thereof.

(3) That the Rules on Procedure of the Federal Open Market Committee adopted effective September 11, 1946, are hereby amended effective immediately as follows: (i) by striking out the words "to its Executive Committee or" in the next to the last sentence of section 2 of such rules, (ii) by striking out the words "under the direction of the Executive Committee" in the last sentence of section 2 thereof, and (iii) by striking out "or its Executive Committee" in section 5 of such rules.

(4) That the by-laws of the Federal Open Market Committee as amended March 1, 1952, are hereby further amended effective immediately as follows: (i) by striking out the words "and the minutes of all meetings of the Executive Committee held since such meeting" in paragraph 1 of section 7 of Article I of such by-laws, (ii) by striking out the word "both" and the words "and the Executive Committee" in the last sentence of section 5 of Article II thereof, (iii) by striking out all of Article III thereof and renumbering Article IV as Article III.

(5) That all actions taken, resolutions adopted, and authorizations granted heretofore by the executive committee, which are still in effect, are hereby adopted by the Federal Open Market Committee as its actions, resolutions, and authorizations as fully and effectively as if they had been originally taken, adopted, or granted by the Federal Open Market Committee and are continued in effect until such time

as they may be rescinded or modified by the Federal Open Market Committee. Any presently existing authority of, or instruction to, any Federal Reserve Bank or the Manager of the System Open Market Account which is derived from action taken by the Executive Committee pursuant to authority conferred upon the Executive Committee by the Federal Open Market Committee is continued in effect, subject to the same terms and conditions as now apply to such authority or instruction, until rescinded or modified by the Federal Open Market Committee. Any matter heretofore requiring action by the Executive Committee must hereafter be acted upon by the Federal Open Market Committee. Any and all powers, authorities, obligations, and responsibilities heretofore conferred upon the executive committee by the Federal Open Market Committee are hereby rescinded.

In taking these actions, it was understood that notices of the changes in the Rules on Organization and Information and in the Rules of Procedure would be published in the Federal Register, and that the amended regulation relating to open market operations would be published in full in the Federal Register.

In response to a question from Mr. Shepardson, Chairman Martin stated that as a part of the action abolishing the executive committee, it would be understood that the Secretary hereafter would notify all members of the Federal Open Market Committee and all other Presidents of the Federal Reserve Banks of all meetings of the Committee. He also stated that it was hoped that all members of the Committee and all other Presidents would be able to attend such meetings in the future.

Secretary's Note: In accordance with this understanding, Section 2 of Article I of the by-laws of the Federal Open Market Committee was changed to eliminate the former provision that alternate members were not entitled to attend meetings of the Federal Open Market Committee except in the absence from a meeting of the member for whom such alternate is elected. The by-laws as amended effective June 22, 1955, are as follows:

ARTICLE I. MEMBERS

Section 1. Organization - Prior to the first meeting of the Committee following March 1 each year, each member of the Committee representing the Federal Reserve Banks shall cause a record of his election and of the election of the alternate to serve in his absence to be forwarded to the Secretary of the Committee. If any question be raised as to the election or eligibility of such member or alternate, the Committee shall determine such question before permitting such member or alternate to participate in the meetings.

Section 2. Alternates - In the event a member is absent from a meeting of the Committee, his alternate, in attending the meeting, shall have the same status as the member for whom he is serving.

Section 3. Oath - Each member of the Federal Open Market Committee and each alternate shall take the same oath of office as that required by the Constitution for officers of the United States.

Section 4. Quorum - Seven members (including alternates present and acting in the absence of members) shall constitute a quorum for the transaction of business; but less than a quorum may adjourn from time to time until a quorum is in attendance.

Section 5. Meetings - The Committee shall meet in Washington, D. C. at least four times each year and oftener if deemed necessary. Meetings shall be held upon the call of the Chairman of the Board of Governors of the Federal Reserve System or at the request of any three members of the Committee. Notices of calls by the Chairman to other members shall be given by the Secretary. Requests of any three members for the calling of a meeting shall state the time therefor and shall be filed in writing or by telegram with the Secretary who shall forthwith notify all members of the Committee in writing or by telegram. When the Secretary shall have sent notices to all members of the Committee that a meeting has been requested by three members and of the time therefor, a meeting shall be deemed to have been called. Whenever any member of the Committee representing Federal Reserve Banks shall find that he will be unable to attend a meeting of the Committee, he shall promptly notify his alternate and the Secretary of the Committee in writing or by telegram, and upon receipt of such notice the alternate shall advise the Secretary whether he will attend such meeting.

Section 6. Conduct and Deliberations - the proceedings, deliberations, discussions, and actions of the Committee, except as required by law and except as authorized by the Committee, shall be strictly confidential, and no information shall be released except as authorized by the Committee and in the annual report required to be made to Congress by section 10 of the Federal Reserve Act as amended.

Section 7. Order of Business - The following shall be the order of procedure to be followed at meetings of the Committee:

1. The Secretary shall present the minutes of the last meeting of the Committee.

2. The Manager of the System Open Market Account shall make his report of all operations of the System Open Market Account occurring since the preceding meeting.

3. The Committee Economist shall make his report.

4. The Committee shall then consider open-market policies.

By a majority vote of members present, the Committee may adopt a different order of business for any particular meeting.

ARTICLE II. OFFICERS

Section 1. Chairman and Vice Chairman of the Committee - At its first meeting on or after March 1 of each year the Committee shall elect a Chairman and a Vice Chairman to serve until the first meeting on or after March 1 of the next year. The Chairman of the Committee shall preside at all meetings thereof and shall perform such other duties as the Committee may require. The Vice Chairman shall perform the duties of the Chairman in the absence of the Chairman.

Section 2. Secretary and Assistant Secretary - At its first meeting on or after March 1 of each year the Committee shall elect a Secretary and an Assistant Secretary to serve until the first meeting on or after March 1 of the next year. It shall be the duty of the Secretary to keep minutes of all meetings of the Committee and a complete record of the action taken by the Committee upon all questions of policy relating to open-market operations and he shall record the votes taken in connection with the determination of open-market policies and the underlying reasons assigned therefor. He shall have custody of such minutes and records and shall perform such other duties as the Committee may require. In the absence of the Secretary of the Committee, the Assistant Secretary shall act as Secretary pro tem.

Section 3. Economist and Associate Economists - At its first meeting on or after March 1 of each year, the Committee shall elect an Economist to serve until the first meeting on or after March 1 of the next year. The Committee shall also from time to time, as it may decide, elect one or more Associate Economists. The Economist shall prepare for the use of the Committee and present to it such information about business and credit conditions as will assist the Committee in the determination of open-market policies, and shall perform such other duties as the Committee may require.

Section 4. General Counsel - At its first meeting on or after March 1 of each year the Committee shall elect a General Counsel and an Assistant General Counsel to serve until the first meeting on or after March 1 of the next year. It shall be the duty of the General Counsel to furnish such legal advice as the Committee may require. In the absence of the General Counsel, the Assistant General Counsel shall act as General Counsel pro tem.

Section 5. Manager of the System Open Market Account - The Committee shall select a Federal Reserve Bank to execute transactions for the System Open Market Account. Such Bank shall select a Manager of the System Open Market Account who shall be satisfactory to the Committee. He shall serve at the pleasure of the Committee and shall attend all meetings of the Committee.

Section 6. Filling Vacancies - At any meeting the Committee may fill any vacancy in the office of Chairman, Vice Chairman, Secretary, Assistant Secretary, Economist, Associate Economist, General Counsel, or Assistant General Counsel.

ARTICLE III. AMENDMENTS

These by-laws may be amended at any meeting of the Committee by a majority vote of the entire Committee.

Mr. Vest inquired whether, in approving the abolishment of the executive committee, the Committee also approved the revisions in the form of directive heretofore issued to the Federal Reserve Bank of New York, which revisions he had outlined earlier this morning in describing the changes that would be necessary if the executive committee were abolished, including the omission from the revised directive of the clause formerly in the full Committee's directive to the executive committee relating to action to be taken to correct a disorderly situation in the Government securities market.

Chairman Martin responded that it was understood by the Committee's vote that the revised directive outlined by Mr. Vest earlier during the meeting was approved as to form, as the directive to be issued later during this meeting by the Committee to the agent Bank.

Secretary's Note: In view of the action of the Federal Open Market Committee abolishing the executive committee at this meeting, members of the executive committee individually indicated to the Secretary their approval of the minutes of the meeting of the executive committee held on June 6, 1955 in the revised form in which they were distributed on June 20, 1955.

Mr. Riefler stated that a question recently was raised by a member of the executive committee who did not expect to attend a meeting of that committee whether, in the absence of himself and the associate economist from that Bank, it would be appropriate to have another member of his staff (an economist) attend a meeting of the executive committee as an observer. Mr. Riefler said that after discussing the matter with Chairman Martin, it was agreed that the question of the extent to which observers should be invited to attend meetings of the Federal Open Market Committee should be discussed at this meeting.

Mr. Sproul said that if a member of the committee made an express request that a member of his staff attend a specific meeting, it might be desirable to permit such attendance as a means of preserving as much continuity in attendance at meetings of the committee as was possible. However, Mr. Sproul questioned the advisability of extending unduly the size of the meetings since there was a tendency for them to grow into "town meetings" and the larger the number in attendance, the less likely that the discussions would be of the character that discussions at open market meetings should be.

Chairman Martin commented that this was the approach he took to the suggestion. He thought the burden of responsibility should fall on the individual members of the Committee and the other Reserve Bank Presidents to attend the meetings or to have their alternates present if it came to voting on matters before the Committee. Chairman Martin also noted that the larger the number of persons attending meetings, the more difficult it became to maintain the confidential nature of the discussions and actions.

Mr. Young said that he would not be in favor of having staff members brought into the meetings as observers and that in his view continuity of attendance could be preserved through attendance of the members of the Committee, the other Reserve Bank Presidents, and the associate economists.

Mr. Fulton expressed a somewhat different view, stating that it would be helpful to have different members of the staff know how meetings were conducted. He did not think this should be a regular practice but felt there were advantages to be gained by having observers present occasionally.

> Following a discussion, Chairman Martin suggested, and it was agreed, that in the light of the comments made at the meeting, it be understood that as a general practice observers would not be permitted to attend meetings of the Federal Open Market Committee. It was also understood that this was not intended to restrict a President from giving members of his staff access to necessary documents on the basis of the broad responsibility that the individual President might feel for keeping himself and his staff informed.

Chairman Martin then called upon Mr. Vest for comment on a memorandum distributed under date of June 2, 1955 with respect to possible changes in the wording of the directive from the Federal Open Market Committee, discussed at the meeting on May 10, 1955. The memorandum reviewed the changes in wording which had been discussed at that meeting and suggested alternative language that might be used in the event the directive were to be changed. It stated, however, that it was the consensus of the staff that it would be preferable not to make a change in the form of the directive in the immediate future unless some further change of policy of the Committee should make necessary a change in the directive.

During the ensuing discussion, several members of the Committee indicated that they felt the alternative wording presented in Mr. Vest's memorandum of June 2 would be preferable to that now in the directive, but that they would not be disposed to make a change solely for the purpose of modifying language. Chairman Martin commented that the question was largely a matter of "tidying up" wording, that he did not have a strong feeling on the question, but that his judgment would be that while the revised wording would improve the language of the directive it would be preferable not to make a change unless some further change of policy of the Committee was being made.

Some additional changes in language were also suggested during the discussion, and Chairman Martin commented that he felt it was not practicable to draft language for a directive in meetings of this size. At the conclusion of the discussion, it was agreed that the revised language outlined in Mr. Vest's memorandum should not be incorporated in the directive at the present time but that it would be considered whenever a change in policy made some change in the wording of the directive necessary.

Chairman Martin next referred to a memorandum from the Secretary with respect to suggested revisions in several continuing operating policies of the Committee as proposed by Mr. Robertson at the meeting on March 2, 1955, which was sent to the members of the Committee under date of June 3, 1955. At his request, Mr. Robertson commented upon the changes which he would propose be made in the continuing operating policies of the Committee, noting that his changes were intended to be changes of language which would clarify the intent of the Committee in its continuing statements of policy relating to support of Government securities, intervention in the Government securities market, operations in the short-end of the market, operations during a period of Treasury financing, and operations for the purpose of providing or absorbing reserves. Chairman Martin then called upon Mr. Sproul who made a statement substantially as follows:

> I am sure that you will all understand that I continue to be opposed to anything which tries narrowly to limit System or Open Market Committee responsibility solely to the volume of bank reserves, that I continue to oppose our renunciation of all or any transactions directly related to security issues involved in Treasury financings and the prohibition of swaps, and that I oppose the limiting of our transactions to short term securities, preferably bills.
>
> Whatever suggestions I have to make concerning Governor Robertson's proposed wording of our directives with respect to continuing operating policies are, therefore, relatively minor and probably gratuitous, since I probably will have to vote against the whole resolution.

Mr. Sproul then suggested some changes in language which he felt might be desirable if the revision proposed by Mr. Robertson were to be acted upon.

Chairman Martin stated that he hesitated to have language of policy statements changed without having given an opportunity for all members of the Committee to study the suggested changes carefully. It was his view that the proposal made by Mr. Robertson as well as the suggestions made by Mr. Sproul should be made available to all members of the Committee before they were called upon to vote on a change.

Mr. Sproul said that he agreed with the position taken by Chairman Martin, that he felt it was desirable to have time to study the proposed language of the statements of operating policies, and that it was not practicable for the Committee as a whole to draft language in meetings such as this.

> Following further discussion, Chairman Martin's suggested procedure was approved unanimously.

At the meeting on March 2, 1955, Mr. Robertson made a statement with respect to the use of repurchase agreements in which he proposed that their use be continued where considered advisable, not as a supplementary technique in the regulation of credit, but for the purpose of enabling dealers in Government securities to maintain broad and ready markets. His statement suggested that this procedure be utilized in a manner similar to rediscount operations--an open window for carrying dealers at rates preferably above but in no event below the discount rate--in order to assist them in sustaining a closer and more continuous market. Under this arrangement, dealers should feel assurance that the facility was always available to them within reasonable limits, as the discount window is open to member banks.

Chairman Martin noted that it had been understood that Mr. Robertson's proposal would be considered at this meeting, and he then called upon him to make such supplementary remarks as he felt were desirable in connection with his suggestion.

Mr. Robertson said that he continued to have grave doubts as to the legality of the repurchase instrument and as to its efficacy in providing or absorbing reserves in the market. He had the feeling, he said, that the same results could flow from thoroughly legal instruments, such as cash transactions in Government securities. The major point with respect to repurchase agreements, he said, was that they were for the purpose of aiding dealers in making markets for Government securities, and this he thought could be done much more efficiently if the Federal Reserve Banks made a completely impersonal arrangement similar to that followed in discount policy.

Mr. Mills said that he had two questions regarding Mr. Robertson's proposal. First, the purpose of repurchase agreements, he said, was to supply reserves to the market through a device other than general open market operations. This being the case, the judgment as to when those reserves should be provided properly should rest with the management of the System account. The initiative for providing or absorbing reserves should lie with the System, Mr. Mills said, rather than with individual dealers whose reasons for seeking repurchase agreements might not necessarily coincide with the objectives of System policy. Secondly, Mr. Mills said that an arrangement such as Mr. Robertson proposed was objectionable in that through it the System would in a sense be granting limited membership in the Federal Reserve System to the dealers. He did not feel this would be warranted.

Mr. Bryan said that he was sympathetic to Mr. Robertson's proposal. As he had observed the use of repurchase agreements, the instrument did not have the purpose of a monetary policy instrument for adding to or detracting from reserves. It was a device that could give some assurance to the Committee that it did not get a rate that went far beyond the intentions of the Committee in periods of tightness. Thinking of the discount rate as the considered System policy, Mr. Bryan said that he felt the System might use the repurchase agreement at some penalty rate above the discount rate, knowing that so long as it was above the discount rate dealers would scramble otherwise to obtain funds before resorting to the repurchase agreement. Mr. Bryan said that he had tended to view the instrument in this manner rather than as an instrument of monetary policy. If it was an instrument of monetary policy, he doubted whether it was a good one.

Chairman Martin said that he was sympathetic to the view expressed by Mr. Bryan as well as that of Mr. Robertson, but that he thought there were problems of administration of a proposal such as Mr. Robertson had made and such a change in policy should not be embarked upon without thorough study. Chairman Martin said that he preferred impersonal dealing to personal dealing at all times, and that this was one of the problems the Committee should be studying continuously. He then called upon Mr. Sproul for an expression of his views.

Mr. Sproul made a statement substantially as follows:

1. I disagree with Governor Robertson's general view that repurchase agreements should not be used as a supplementary technique in the regulation of credit but should be used for the purpose of enabling dealers to maintain broad and ready markets. I think that they have a real place and purpose as a supplement to more general credit controls and cannot now be used to enable dealers to maintain broad and ready markets.

2. Dealers are not now prevented from making broad and ready markets by an absolute shortage of funds. They can all borrow up to the prudent limits any lender would set in relation to capital. What they would like to have is assured access to funds at lower rates so that they would always, or nearly always, have a profit on the "carry" of their securities in position. No central bank can give such assurance without also giving up its initiative in credit control, and there is no warrant in law or in fact for such a relinquishment to enable dealers to make broader markets.

3. The risk of conflict with the initiative of the central bank and with general credit control admittedly depends in degree on just how the proposal was developed in practice: at one extreme, if it were to be an open window but always at a penalty rate there would be little or no risk because there would be little or no use of the privilege. At the other extreme, if it were to be an open window at rates always favorable to making a profit on the "carry" it would make the market broader by floating it in a sea of Federal Reserve credit, no matter what general credit policy might be. In between these extremes, that is, with a variable rate used to promote or retard repurchase agreements <u>at our initiative,</u> you would only be substituting rate variation for present quantity (and rate) variation which we now use.

4. The analogy with member bank borrowing is, I think, misleading. The discount window is open as a privilege not a right, there are no credit lines to be drawn on at will, and the suggestion that member banks should borrow freely and continuously to enable them regularly to carry part of their assets has usually been frowned upon.

5. Broadly speaking, dealers now make broad markets and carry longer positions when they see prospects of rising prices, and narrow markets and small positions when they see prospects of falling prices. In general, there are only two kinds of situations when a dealer's borrowing needs exceed or seem to him to exceed the limit of funds available to him.

(a) When he has become overextended in relation to his capital,
(b) When the money market has tightened and individual banks are reluctant to borrow at the Federal Reserve Bank in order to advance additional funds to the dealer.

We certainly would not want to step in to relieve the first situation, and to relieve the second, whenever it represented an intended result of credit policy, would be partially to nullify that policy. When the tightening is temporary and not an intended result of credit policy, the present use of the repurchase agreement is effective and appropriate as a supplement to outright open market operations and the discount window.

6. If our markets were differently organized, the situation of the dealers might be improved. In the London market for example, short term dealer portfolios can generally be carried at a profit, whereas here they must normally expect some loss on the "carry" of short-term securities and try to make it up on the spread between their bid and asked quotations and on fluctuations in prices when their guesses as to future price movements are correct. To reproduce the London situation even in part would mean that our money market banks ordinarily would have to lend to dealers on short-term securities at lower rates than are now available, that they would vary these rates from day to day in line with changes in their reserve position, and that the dealers would come to us only as a lender of last resort and at a penalty rate when there is temporarily a shortage of available funds in the market. They would then be able to average out their occasional losses, when borrowing at the penalty rate, with their usual profits and would presumably be encouraged to carry larger positions and to make broader markets. It would be desirable to study further whether and how such an institutional change in our markets might be brought about. Short of that, I do not see what Governor Robertson's proposal has to offer.

Mr. Bryan said that Mr. Sproul's statement made an orderly argument in so far as he could follow the statement orally, and he suggested that copies be distributed for further consideration.

Chairman Martin said that it would be understood that Mr. Sproul's statement would be made available to all members of the Committee in writing, and that further study would be given to the matter at a later meeting.

Before this meeting there had been sent to the members of the Committee a memorandum from Mr. Riefler dated June 20, 1955, giving a list of the persons to whom minutes and other records of the Federal Open Market Committee had been made available, as indicated by reports made to the Secretary pursuant to the authorization given at the meeting on March 2, 1955. A copy of this memorandum has been placed in the Committee's files.

Mr. Riefler stated that the memorandum was distributed because he felt it would be of interest to the members of the Committee and the other Federal Reserve Bank Presidents to know how extensively minutes and other Committee records were being made available under the authorization given last March, which provided that any member of the Committee or any other Reserve Bank President could make such records available to any employee of the Federal Reserve System in his judgment, provided he notified the Secretary of those to whom the records were made available. Mr. Riefer noted that in the reports some Federal Reserve Banks indicated by name secretaries and files personnel handling such records, while others did not so indicate. Mr. Riefler also called attention to the fact that at some Federal Reserve Banks minutes of open market meetings were made available to virtually no one outside the President's office, whereas at other Reserve Banks such minutes were available to several persons.

Prior to this meeting there had been sent to the members of the Committee alternative drafts of a letter to be sent by Chairman Martin to the Comptroller General of the United States with respect to the request made by the Chairman of the House Committee on Government Operations that the General Accounting Office make an audit of the Board of Governors, the Federal Open Market Committee, and the Federal Reserve Banks and their branches, and at this meeting a revised draft of letter was distributed.

At this point, the meeting recessed for fifteen minutes, reconvening at 11:46 a.m. with the same attendance as at the beginning of the recess.

After discussion, the letter to Mr. Campbell, as changed at this meeting, was approved in the following form:

"This letter refers to our previous correspondence with respect to the request you received from Chairman Dawson of the House Committee on Government Operations that the General Accounting Office make an audit of the Board of Governors, the Federal Open Market Committee, and the Federal Reserve Banks and their branches for the period January 1, 1953 to December 31, 1954.

"In my letter to you of April 20, I stated that since the proposal represented an important departure from long established practice, with far-reaching implications, we would consult as promptly as possible with the Federal Open Market Committee, which is a statutory entity, and with the chairmen, and presidents of the Federal Reserve Banks. In the interim we have done so, and the Board has given further consideration to this request. In addition, I have had two meetings with Chairman Dawson regarding the matter.

"At the outset I think it should be clearly understood that the question before us is not whether the Board, the Federal Open Market Committee, and the Reserve Banks should be audited. They are audited in accordance with standard practices and exacting procedures, and reports of these audits are available to the appropriate Committees of Congress. For the past three years the Board has furnished the reports of the audits made of its accounts to the House and Senate Banking and Currency Committees. Last year the Board also sent the reports of examination covering the five years 1949-1953 of the twelve Federal Reserve Banks and branches, as well as the audit of the Federal open market account to the House Banking and Currency Committee where they could be examined by all members of the Congress who wished to see them. The Board stands ready at all times to make reports of audits of its own operations, as well as the reports of examination of the Reserve Banks and the audits of the Federal open market account, available to appropriate Committees of Congress.

"The matter of a separate audit by the Comptroller General presents a different question, and we believe that in the light of the statutes, legislative history, and explicit expressions of Congressional intent, the Board, in the absence of an express directive from the Congress, could not lawfully acquiesce in a separate audit made by your office.

"Chairman Dawson's request that you audit the Board, the Federal Open Market Committee, and the Reserve Banks is predicated upon section 53(b) of Title 31 of the United States Code, which was enacted as a part of the original Budget and Accounting Act, dated June 10, 1921. This Act provides in part that the Comptroller General 'shall make such investigations and reports as shall be ordered by either House of Congress or by any committee of either House having jurisdiction over revenue, appropriations, or expenditures.' The context of section 53 seems to us to relate clearly to public funds appropriated by and expended in accordance with the directions of Congress.

"When the General Accounting Office was established in 1921, no exception was made with respect to the Federal Reserve Board. Accordingly, the accounts of the Board, but not those of the Reserve Banks and their branches, were audited for a number of years by the Comptroller General. However, in the Banking Act of 1933 Congress terminated the authority of the Comptroller General in this respect. That Act amended section 10 of the Federal Reserve Act to provide explicitly that funds of the Board, which are derived from assessments on the Federal Reserve Banks, 'shall not be construed to be Government funds or appropriated moneys.' It provided further that 'The Board shall determine and prescribe the manner in which its obligations shall be incurred and its disbursements and expenses allowed and paid...' The reports of the Senate and House Banking and Currency Committees on this amendment stated that its purpose was to leave 'to the Board the determination of its own internal management policies.'

"During the enactment of the Government Corporation Control Act, in 1945, Congress gave consideration as to whether or not the Federal Reserve Banks should be brought within the purview of that Act, so as to be audited by the General Accounting Office. Congress did not include the Federal Reserve Banks within that Act. At the hearings before the Senate Committee on Banking and Currency on the bill S.469, which became the Government Corporation Control Act, Mr. Frank H. Weitzel, attorney for the General Accounting Office, testified on behalf of the Comptroller General to the effect that Federal Reserve Banks should not be made subject to the bill for the reason that they were supervised very closely by the Board.

"As you know, there is a bill (H.R. 2643) pending in the present Congress which would provide for an audit by the Comptroller General of the Board, the Reserve Banks, and the Open Market Committee. A similar bill was considered but not reported by the House Committee on Government Operations in the last Congress. These measures were predicated, apparently, on the assumption that, if such an audit is to be undertaken, it should be authorized by an Act of Congress.

"You may be assured of our desire to cooperate at all times with your office, as well as with the Committees of Congress, but in the light of the statutes and expressions of legislative intent we feel we must adhere to the conclusion stated above.

"I have assured Chairman Dawson that, if it meets with his approval, we would welcome an opportunity to appear before his Committee in order to present the important policy considerations which are raised by this proposal beyond the legal aspects of the matter dealt with in this letter."

Secretary's note: The letter was sent by Chairman Martin to Mr. Campbell, Comptroller General of the United States under date of June 22, 1955, with a copy to Chairman Dawson, Chairman of the Committee on Government Operations of the House of Representatives.

Members of the staffs of the Board's Division of Research and Statistics and Division of International Finance entered the room at this point for the purpose of assisting in the presentation of an economic and credit review, illustrated by chart slides. A copy of the script of the review has been placed in the Committee's files, and copies were sent to all members following the meeting.

The review indicated that economic activity is continuing to rise from record levels, with expansion activated by private spending. Credit demands are very strong. Gross national product in the current quarter is now estimated at an annual rate of $377 billion-- up $7 billion from the first quarter of this year and also $7 billion above the second quarter of 1953. Industrial production in May reached a new high of 138--15 points above the 1954 low and 1 point above mid-1953. Some further increase appears to be occurring in June. A striking feature of the recent period has been stability in broad averages of commodity prices, despite sharp expansion in output.

While industrial capacity and manpower resources, on the whole, are being used fairly intensively and while some materials are in tight supply, the degree of utilization of the country's resources--with some exceptions--is not as intensive as in the spring of 1953. Since then, there have been two years of growth in the labor force, in productivity, and in capacity. In the spring of 1953, however, activity was leveling off, whereas this spring it has been advancing.

The review also presented projections of requirements for bank reserves which indicated that something over $1-3/4 billions of additional Federal Reserve credit will be required during the rest of 1955. About $700 million of reserves would need to be provided during the next two weeks to cover seasonal and holiday currency requirements as well as the usual end-of-month decline in float. With the release of reserves by passage of July 4 holiday demands, there should be adequate reserves to cover the requirements of Treasury financing and most other demands until the last quarter of the year without further System operations, except for temporary periods such as around Labor Day. The remaining $1 billion of reserves would be needed mostly during October and between Thanksgiving and Christmas.

The means by which the additional Federal Reserve credit is supplied in the next few months will influence the tone of credit markets and perhaps the nature of developments, the review said. The strong economic situation, the delicate balance of psychological forces in current financial markets, the obvious desirability of avoiding public misunderstanding of System policy at this time, and the timing factor of when the reserves are needed all seem to point to open market operations, rather than reserve requirement reduction. Some additional borrowing by member banks may be appropriate, depending on the strength and nature of credit demands. Vigorous demands for credit, particularly if of a speculative nature, may call for the restraint of increased member bank borrowing, and such restraint could be reenforced if necessary by a further rise in the discount rate.

The meeting then recessed for lunch and reconvened at 1:45 p.m. with the same attendance as at the beginning of the morning session except that Messrs. Hostetler, Rice, and Wheeler, were not present.

Chairman Martin referred to the economic review presented before lunch, stating that it was his belief that the economy was in the midst of prosperity. In making this comment, he said, he was not unaware that there was some unemployment and that in some segments of the community, such as in coal mining areas, there were technological shifts taking place affecting employment. He also noted that in the farm area there were problems which "marred" the general pattern somewhat. However, he felt that this was the most prosperous period the country had ever been in. Chairman Martin referred to the statement made by Mr. Sproul at a recent meeting of the executive committee at which he cautioned the Open Market Committee that credit policy was not solely responsible for the level of business activity. The Chairman stated that he felt this was an excellent point to bear in mind. However, he felt that the psychology of prosperity had not been built up to a point where there was a very real element of danger that monetary and credit policy might produce a situation of undue optimism. Chairman Martin said that it would be desirable today to review discount rate policy, money supply policy, and reserve requirement problems, all in the light of the forthcoming Treasury financing. He referred to the projections of reserve funds prepared by the staff, indicating what the need for additional reserves would be in coming weeks, and he also noted that as far as operations for the System account were concerned there recently had been a tendency (through no fault of anyone) for the volume of free reserves to be reflected on the "easy" side of the zero-to-$100 million range plus or minus, rather than on the down-side of that range. If ever there had been a period when it would have been desirable to have had free reserves ranging lower than the projections, this would have been the time, Chairman Martin said. The Committee was now faced with a period in which it would have to supply reserves to meet seasonal requirements, to meet growth in the economy, and to assist in the Treasury's financing. He likened the present situation to one in which a driver of an automobile was going up a hill and as the grade increased found it necessary to increase pressure on the accelerator: it was a question how much more reserves should be supplied in order to maintain the existing situation.

Chairman Martin then called upon Mr. Sproul who made a statement substantially as follows:

1. As shown in the reports this morning and as we have all observed, I think, there is continued growing strength in the economic situation at high levels of production and employment. This warrants a feeling of satisfaction, tempered by the fact that activity has been supported by rapid expansion in consumer and mortgage credit on easy terms, and by the likelihood that prices, after two years of stability, may now break out on the up-side, due to pressure from costs and anticipation of price rises by businessmen and consumers.

2. With continued strength in the economy at the highest levels yet reached, some evidence has developed of a nearer approach to full utilization of existing plant, equipment, and manpower than in the recent past, but there still appears to be some leeway for increased production and increased productivity, in a highly competitive economy, to counteract these cost-price influences in part. Restraint from the credit side can be helpful but not controlling in such a situation. The pressure of existing credit restraint will increase as demand for credit increases in coming months, and we shall have to be alert from here on to the need for further restraint; to signs of price and credit inflation. Such signs would include rapid growth of credit to finance inventories, indications of speculative buying in anticipation of price increases, further rapid growth of consumer credit, another speculative surge in the stock market, and in general the development of super boom psychology.

3. Even if the rate of growth in the economy should be less in the third quarter of 1955 than in past two or three quarters, the great breadth of the present upward movement, including nondurable and durable goods, suggests that whatever slackening in automobile production and whatever levelling off of housing activity may take place during next three months will be largely offset by a continued push upward in other areas. The recent upward revision of prospective business expenditures for capital equipment, the continued high level State and local expenditures, and the continued evidence of economic strength in many foreign countries, and the general air of optimisim, reinforce this view.

4. The Treasury picture is largely unchanged. It will have to issue around 9 or 10 billion of new securities during last half of the calendar year, though not all of this is net borrowing. Some 2 or 3 billion will be in replacement of redeemed savings notes, attrition on maturing issues, and to redeem CCC certificates and maturing issue loans. Treasury borrowing, most of which will presumably be at short term and much of which will have to be done through the banks, will require the addition of reserve funds to the bank pool. It carries possible inflationary elements which will have to be guarded against.

5. Private demands for bank credit during the remainder of the year are also expected to be substantial, after a contra-seasonal rise during the first half of the year. Seasonal needs and some growth needs will require additional reserve credit, particularly as many banks would appear to have approached or reached the limit of possible shifts of short term securities to nonbank investors, in order to make way for increased loans. The total amount of reserves needed to maintain existing credit conditions, without relaxation of present restraint, is estimated to be in the neighborhood of 2 billion.

6. It now appears that these combined reserve needs growing out of private demands and Treasury borrowing can be met by open market operations supplemented by an increase in discounting at the Federal Reserve Banks. Most of the increase in member bank borrowing this year has been at country and reserve city banks; there is still room for further borrowing and for this kind of pressure to be felt more largely at the central reserve city banks. This would afford a measure of insurance against a too free dispensation of reserves through open market operations.

7. Our primary task is to provide the reserves needed by a prosperous growing private economy, and our secondary task is to provide the reserves needed to facilitate unavoidable Treasury financing so that it will neither absorb funds needed by the private economy nor be the vehicle for an excessive credit expansion. This will mean treading a pretty narrow path between too little and too much. Open market operations are convenient for the main part of the task, but the finer adjustments both in terms of reserves provided and in terms of keeping the right amount of pressure on the reins can come from seasonal use of the borrowing privilege. An increase in member bank borrowing, in the aggregate, should be welcomed, as seasonal needs develop. We should be ready to meet reasonable demands at the discount window. We should also be ready to increase the discount rate when the business and credit situation suggest it and the Treasury's financing schedule permits it. Continued pressure on the banks and an enlarged supply of short term Government securities should result in a rising trend of short term interest rates, which could set the stage for another increase in the discount rate either after the Treasury's July-August cash financing or before its October cash financing.

Chairman Martin inquired of Mr. Sproul as to his views regarding Mr. Rouse's comment at the beginning of this meeting concerning gossip in some parts of the money market to the effect that the discount window at the Reserve Bank was "closed a la 1953".

Mr. Sproul stated that it was difficult to understand this feeling, that whenever the question had been brought up the response was that there was no practice in the Federal Reserve Banks that would lead to gossip of the sort indicated. Mr. Sproul said that he had no reason to doubt that the feeling did exist, however, and that in some way the impression had gotten around that the Federal Reserve was not going to welcome borrowers at the discount window this year.

Chairman Martin said that this was an important point to bear in mind. He did not believe that the System could dissipate the gossip by a statement; it would have to do it by the actions taken at the discount window.

Mr. C. S. Young stated that in Chicago he had observed the same feeling as that indicated by Mr. Rouse, and Mr. Erickson made a similar comment with respect to the Boston District.

Mr. Johns said that in the Eighth District he thought there was no misunderstanding with banks about administration of discount policy when discussions were on the basis of a specific situation. However, when discussions were in general terms, there had been an impression, perhaps growing out of the recent revision of Regulation A, of doubt as to whether discount policy had changed.

Mr. Bryan expressed the view that, in part, member banks wished to misunderstand discount policy. He had had occasion, he said, to talk with several banks in the Atlanta District recently about their situations and, despite the care used in discussing the matter with them, some had "gone out and gossiped" to the effect that the Federal Reserve did not wish to take care of member banks at the discount window this year.

Mr. Robertson commented that he thought it would be possible to over-emphasize the feeling reported to exist and that the System might well find that actions taken to correct the feeling might result in promoting the idea that the discount window was "wide open."

Chairman Martin said that Mr. Robertson had made a good point and that, as indicated before, he felt the best procedure was for each Reserve Bank President to use his judgment in trying to clarify discount policy as the occasion arose, and not to make any concerted drive in this direction.

Turning to operations for the System Open Market Account, Chairman Martin inquired of Mr. Sproul whether his view was that the Committee should continue to try to maintain free reserves ranging from zero to $100 million, plus or minus.

Mr. Sproul responded that his thought was that the Committee should maintain its existing policy, which he had not thought was refined down to a $100 million range from zero. Rather, he had thought that the range might be wider than that in either direction, so long as it did not conflict with existing policy and the volume of free reserves beyond the $100 million range did not last for more than a very temporary period. Mr. Sproul thought that, in addition, the Committee would now have to pay more attention to member bank borrowing and more attention to movements in market rates, rather than looking primarily to free reserves as its single guide.

Mr. Leach said that he thought there should be no change in existing policy but that it would be satisfactory to him if there was a little more tightness than had existed in recent weeks. He felt that the objectives discussed at the June 6 meeting of the executive committee were right but that the degree of tightness that had existed had not quite conformed to those objectives. Mr. Leach said that free reserves should not be the sole guide and he would rather achieve the result with a little more tightness than had been apparent recently.

Mr. Earhart and Mr. Sproul both concurred in Mr. Leach's statement.

Chairman Martin stated that one of the questions was whether to supply reserves during the period of the forthcoming Treasury financing freely or reluctantly. He felt that the Committee should not mislead the Treasury into thinking that it was going to pour reserves in to support the Treasury financing. On the other hand, he would not indicate that the Committee would be reluctant to supply the reserves needed, but that they should be supplied on the basis of current needs. He felt this could not be measured by the words "tightness" or "ease" and he realized how difficult it was to maintain a market situation in line with the Committee's objectives when there was such a small supply of Treasury bills in the market.

Mr. Mills said that he was thoroughly sympathetic at the present time with the point of view of increasing restraint but that such an increase in restraint would be difficult to attain at the time of the Treasury's forthcoming financing. There should be some minimum amount of free reserves in the market at the time of the Treasury financing, he said, to serve as a lubricant which would facilitate the operations of dealers in meeting their own requirements and to assist others during the Treasury financing. Unless there was such a volume of free reserves, Mr. Mills felt there would be a distinct possibility of another refunding with heavy attrition, and the impression might be created that the Federal Reserve was so intent on its own policy that it was indifferent to the needs of the Treasury. This would be more likely to occur if the open market meetings were to be set three weeks apart commencing with this meeting. If the market could have some lead from the Federal Reserve as to the minimum amount of reserves that would be in the market, it might serve the System's purposes as well as the needs of the Treasury more effectively.

Mr. Rouse said that there had been a statistical appearance of greater ease than actually existed in the market. Both in New York City and outside, reports indicated that individual banks felt their situation was tighter recently than it had been earlier. Mr. Rouse felt that within the next three weeks market needs for reserves would be in the magnitude of one-half billion to $700 million, and the bulk of the buying of bills to meet that need would have to be done prior to the probable announcement of the Treasury financing during the week of July 4. Buying by the Federal Reserve in advance of the announcement would be reassuring to the market, Mr. Rouse said, even though the volume of free reserves did not make for a "flush" situation: the mere addition of such reserves would be taken as an indication that the System was going to "see the Treasury through".

Chairman Martin said this was very encouraging. He felt that both the statistics and psychology of the situation needed to be considered.

In response to a question from Mr. Leach, Mr. Rouse expressed the view that bills or other short-term securities would be available to enable the System account to buy what was needed during the next three weeks, and he did not think such purchases would have an undue influence in decreasing interest rates during that period.

In response to a request of Mr. Robertson, Mr. Thomas stated that there were arguments both for and against a reduction in reserve requirements as a way to meet the need for additional reserves during the period of the Treasury financing. Such a reduction would have a psychological effect. It would place in many banks free reserves which they would not use in connection with the Treasury financing and thus those banks would be free to use the reserves in making loans of a less desirable and more speculative character. Mr. Thomas also felt a reduction in reserve requirements would be interpreted as a step toward ease and for the purpose of facilitating the Treasury financing, regardless of what the Committee's current general policy might be. If the reserves were provided through open market operations, presumably they would not be furnished until the pressures were reflected in the market. Further, by providing the reserves through open market operations, a smaller volume might be furnished, depending upon how the situation developed.

Chairman Martin said that since the meeting of the executive committee early in June, he had given a great deal of consideration to the ways in which reserves might be provided. He felt there was no way of making a reduction in reserve requirements so that it would not be misinterpreted: such a reduction would compound the talk of ease. Banks had been advocating a reduction in reserve requirements for some time and there had come to be a tendency to expect such a reduction. Chairman Martin went on to say that following the executive committee meeting on June 6 he, Mr. Sproul, and Mr. Balderston talked with Treasury officials about the matter of providing the reserves that would be needed this summer.

Mr. Balderston said that he felt a reduction in reserve requirements would put funds into the market in the wrong place, in the wrong way, and at the wrong time. It would be completely misunderstood. It would add to the System's difficulties in trying to maintain a degree of "restraint" and still put reserves into the market to meet the various needs that would arise this summer and fall.

Mr. Robertson said that he felt the Committee should be more restrictive than it had been. He would be much happier if it could maintain a greater degree of restraint than had been maintained recently, without jeopardizing the Treasury financing program.

Chairman Martin said that there appeared to be agreement that the existing policy should be continued, and the question was one of how to implement that policy. He then called upon Mr. Rouse for suggestions regarding the instructions to be issued to the New York Bank, and Mr. Rouse indicated that the limitation in the first paragraph of the directive be set at $1 billion rather than the existing

$750 million, in view of the purchases that would be necessary during the next three weeks. It was also noted that the directive to be issued to the New York Bank by the full Committee would be in the form presented by Mr. Vest earlier in this meeting in connection with the discussion of the abolishment of the executive committee. A copy of the revised form of directive was distributed at this point.

Chairman Martin suggested that, in issuing the foregoing instruction, all members of the Committee bear in mind Mr. Mills' point that Committee members keep in touch with the situation and be available in the event it was necessary to communicate with them regarding developments during the next three weeks.

Mr. Mills inquired whether the understanding that operations would be confined to short-term securities, preferably bills, continued in effect, and Chairman Martin stated that this was correct.

Mr. Robertson suggested that the directive to be issued by the full Committee to the New York Bank provide that the Federal Reserve Bank of New York shall not enter into repurchase agreements at a rate below the discount rate of the Federal Reserve Bank of New York.

This proposal was discussed briefly and, at Chairman Martin's suggestion, it was agreed that it should be held over for consideration at the next meeting of the Committee.

Mr. Balderston inquired whether the directive would give authority to the Manager of the System Account to take into account the rate of speed at which the economy was moving in providing reserves during the next few weeks. His view was that the public should understand that the present high level of business justified a higher discount rate than now existed and that if the Treasury financing were not to take place in the immediate future, it would be appropriate to increase the discount rate to 2 per cent at once. However, the System had to take into account the Treasury financing problem.

Mr. Bryan said this was closely allied to the problem that was bothering him regarding the apparent consensus of the Committee. He felt that the situation needed some restraint. He felt the discount rate had not been made effective as a restrictive device because the System had permitted the going rate in the short-term market to be at times substantially below the discount rate and never quite up to it. He wondered, therefore, if it would be appropriate to begin feeding reserves to the market before the short-term rate had gotten up to the discount rate.

Chairman Martin commented that the short-term rate was a product of circumstances largely beyond the System's control at the present time, in view of the short supply of Treasury bills in the market.

Mr. Sproul said that he did not think the Committee should look upon the provision of reserves during the next few weeks as "pouring gasoline on the fire". They were to maintain the existing measure of restraint as nearly as possible in view of prospective overall needs. If the situation continued to need restraint, as now seemed likely, an increase in the discount rate could again be considered when the Treasury financing was out of the way. With respect to Mr. Bryan's comment about not putting reserves into the market until the short-term rate had moved up, Mr. Sproul felt that in the light of the Treasury financing and the attitude existing in the market, it would not be wise to try so precisely and with such a high degree of refinement to say when the System account should begin to put in reserves. If the full Committee were to attempt to do this, it would run a real risk of causing a misunderstanding of System policy and of having the Treasury financing turn out to be a failure, with the result that the whole policy the Committee was pursuing might be lost. It might be consistent with policy to have the short-term rate go up, but Mr. Sproul said that as he saw it there was no great need to have the rate go up within the next two weeks; it could be expected to go up with the increased seasonal demands, with the growth demands, and with the other factors that may be anticipated during the period immediately ahead.

In response to a question from Mr. Robertson as to whether this was the time to consider an increase in the discount rate, Mr. Thomas said that this raised the question of rate relationships. It was a question of a reasonable relationship between the rate at which the System would buy bills, the rate at which it would make repurchase agreements on bills, and the discount rate. The discount rate is a penalty rate and the general approach was that banks should try to make their adjustments in reserve position through the bill market before borrowing at the Reserve Bank as a general rule. Also, if a policy of not making repurchase agreements below the discount rate were to be adopted one might raise the question in terms of rate relationships why the System would purchase any bills below the discount rate.

Mr. Bryan said that he was not suggesting a precise relationship between rates but that he questioned whether the System, on its own initiative, should make massive additions to reserves in advance of a rise in the short-term rate. He felt that it would be desirable if the System account were a little reluctant about large infusions of reserves at this time.

Mr. Thomas stated that the projections indicated it would be necessary for the System account to purchase at least a half billion dollars within the next ten days.

After further brief discussion, Chairman Martin inquired whether there was objection to approval of the directive to be issued by the full Committee to the New York Bank in the form presented by Mr. Vest earlier in the meeting with a limit of $1 billion for the first paragraph.

Thereupon, upon motion duly made and seconded, the Committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the Committee:

1. To make such purchases, sales, or exchanges (including replacement.of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the cose of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1,000,000,000;

2. To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for

the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500,000,000;

3. To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate $500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

Chairman Martin stated that with the abolishment of the executive committee he had in mind that meetings of the full Committee hereafter would be scheduled at intervals of three weeks. He suggested that the next meeting be set for 10:45 a.m. on July 12, 1955, and that it tentatively be understood that meetings also would be held on Tuesdays, August 2, August 23, and September 13, 1955.

Mr. Leach suggested that the practice which had been followed in connection with meetings of the executive committee in the past of distributing to the members of the Committee a staff report on the economic and credit situation be continued for meetings of the full Committee in the future. He felt the report was of more value if it could be received in advance of the meeting so that the Reserve Bank Presidents had an opportunity to review the report of the Board's staff and compare it with information available in the individual districts before the meeting.

Chairman Martin stated that this procedure would be continued in the future.

Thereupon the meeting adjourned.

Secretary.

July 6, 1955

MEMORANDUM:

To Members of Special Committee of the Federal Open Market Committee

Re: Management of the System Open Market Account

From J. L. Robertson

The objective of the Special Committee is to devise an acceptable procedure for achieving closer and more direct contact between the FOMC and the management of the System Open Market Account. When we began our consideration of this problem, I felt that the solution might be the employment of a Manager who was physically located in Washington and who was not an employee of a Federal Reserve Bank.

Further consideration has inclined me to believe that the benefits of having the Manager in New York and an official of the New York Reserve Bank may outweigh the disadvantages. Hence I wonder whether we can eliminate - or at least diminish - the shortcomings of the present arrangement without changing the status or location of the Manager.

I submit for consideration the possibility that this objective might be achieved in large measure by altering and expanding the duties of the Secretary of the FOMC. By virtue of his location in Washington and the ready availability of daily contact with a majority of the members of the Committee, he is permeated to an exceptional degree with the "feel" of Committee policies, just as the Manager develops the feel of the money market through his daily contacts in Wall Street. In the event of need, the Secretary can quickly and conveniently check his understanding of Committee policies with a majority of the Committee members themselves. Finally, by virtue of his separation from the mechanics of the money market, the Secretary is in a position to fix his mind almost exclusively on the major objectives of the Committee's current monetary policies, to a degree that would seem to be psychologically impossible for the Manager, who is necessarily preoccupied, to a considerable extent, with the practical effectuation of policies.

Accordingly, I suggest an arrangement under which no substantial transactions shall be entered into by the Manager until he shall have cleared the proposed action with the Committee's Secretary, as a check on its conformity with the Committee's current policies. In order to allow the Manager some necessary leeway, we might decide that, during a testing period at least, such prior clearance would be called for only on days when the Manager contemplates transactions of substantial volume - say $30 million or $40 million.

The suggested arrangement might strengthen the control of the Committee over the effectuation of its policies while preserving the benefits of management located in the prime money market and constituting a part of the New York Reserve Bank as the Committee's institutional agent. The functions of the two officers would complement each other, and our operations would benefit from the double check of the Secretary's intimate daily contact with Committee thinking and his detachment from direct concern with the practical problems of open market transactions, in addition to the benefit of the Manager's immediate and continuous knowledge of market conditions. It seems possible that a plan of this nature, modified and perfected by trial and error, might develop into an arrangement combining direct responsibility and control with practical and efficient operation.

Needless to say, this is in no sense a suggestion that the Secretary take over functions heretofore performed by the executive committee; those functions will be performed by the full Committee, in accordance with our recent decision. The Committee will not be delegating any of its discretionary powers to its Secretary; his actions in cooperation with the Manager will be based simply upon his understanding of Committee policy as it applies to the day's (or hour's) proposed open market transactions. Nor would the Secretary have any authority to direct the Manager to take any specified action, although he should feel free to initiate discussion (either with the Manager or with members of the Committee) of proposals for transactions that seem to him to be in keeping with the objectives of the Open Market Committee. His sole authority in this connection would be to veto any proposed course of action that seemed to him to be contrary to Committee policy. In all probability this authority seldom would be exercised. In case the Secretary was doubtful as to the will of the FOMC, he would be expected to contact all available members of the FOMC and ascertain the majority view with respect to the matter in question.

Under the suggested arrangement, the Secretary - like the Manager - would report to the Committee regularly on his activities with respect to open market operations, including consultations with members of the Committee regarding proposed transactions.

The foregoing proposal would require the Secretary to devote all of his time to Open Market Committee matters. This seems clearly justified by the importance of our duties in the field of monetary regulation and the advisability of the closest and most efficient possible coordination of policy decisions with day-to-day operations. Consequently, the Secretary should be released from all other duties, although he would continue to be selected by the Open Market Committee from among the Board's employees and he would remain on the payroll of the Board of Governors.

October 25, 1955

Memorandum:

To Members of Special Subcommittee of the Federal Open Market Committee

Subject: Management of the System Open Market Account

From J. L. Robertson

The past year has seen the introduction of proposed legislation to abolish the Open Market Committee and to transfer its functions to the Board of Governors, and the Board has received a publicized recommendation that the "executive offices" of the Open Market Committee be transferred from New York to Washington.

I believe that the membership on the Open Market Committee of five Federal Reserve Bank Presidents adds materially to the strength of the Committee and the soundness of its judgments and operations. The question of physical location of the Account Manager is a more doubtful one, but I am satisfied that, for the present at least, the disadvantages of removing the Manager from New York to Washington would outweigh the possible benefits.

Nevertheless, there is some validity in one idea that underlies the proposals referred to - namely, that it would be desirable for the Account Manager to be more directly and exclusively responsible to the Open Market Committee than presently is the case. The job of this Subcommittee is to devise a procedure that will make System Account transactions reflect the Committee's policies as accurately as possible, while preserving the advantages of having the Manager located in New York, the nation's financial center.

To this end I suggest the advisability of proceeding in accordance with Chairman Martin's memorandum of May 10, 1955 on the "Status of the Manager of the System Open Market Account". Briefly summarized, the Chairman's proposal was that the Committee should select the Manager and fix his salary, and that the Manager should devote himself entirely to the work of the Committee and should be responsible solely to the Committee. The Manager and his staff would be on the pay roll of the New York Federal Reserve Bank, but apart from such "personnel" arrangements for convenience, the Manager and his staff actually would be employees of the Committee. The physical situs of our Open Market operations would remain in New York, but the step from policy to operations would be directly from the Committee to the Manager, rather than through the intermediacy of the New York Bank, as at present.

At worst, direct responsibility of the Manager to the Committee (rather than responsibility through an intermediary, the New York Bank) could hardly diminish the responsiveness of the Manager to the Committee's wishes; at best, the responsiveness of the Manager would be enhanced by the removal of an unnecessary link in the chain between policy formation and operations. In other words, it may be that there is nothing to be lost and something substantial to be gained by a more direct relationship between the Manager and the Committee. An additional benefit of the Manager's not being a part of the operating structure of the New York Federal Reserve Bank would be that the Manager would no longer be responsible to, and report to the directors of that Bank, and the possibility of "leaks" in that area would be avoided. This is not to imply that such leaks have occurred, but merely that it is advisable to avoid any chance of such occurrences if that can be achieved without loss of other advantages.

Of course, the Manager should have access to all pertinent information and material in the System and the benefit of any studies which relate to Open Market work. It is probable that the Manager and his staff should undertake the task of training others throughout the System in Open Market techniques so that there would always be a supply of persons available to fill vacancies in the staff at all levels.

The foregoing arrangement would represent a long step in the right direction, but in my opinion it does not provide a complete answer to the question of how we can establish a more appropriate relationship between the Open Market Committee and the execution of its policies. Therefore, I submit for consideration a refinement along the lines of the suggestion contained in my memorandum to the Special Committee on July 6, 1955. This refinement involves an expansion of the duties of the Committee's Secretary. As I stated in that memorandum, by virtue of his location in Washington and the ready availability of daily contact with a majority of the members of the Committee, the Secretary is permeated to an exceptional degree with the "feel" of Committee policies, just as the Manager develops the feel of the money market through his daily contacts in Wall Street. In the event of need, the Secretary can quickly and conveniently check his understanding of Committee policies with a majority of the Committee members themselves. Finally, by virtue of his separation from the mechanics of the money market, the Secretary is in a position to fix his mind almost exclusively on the major objectives of the Committee's current monetary policies, to a degree that would seem to be psychologically impossible for the Manager, who is necessarily preoccupied, to a considerable extent, with the practical effectuation of policies.

Accordingly, I suggest an arrangement under which the Manager of the Account and the Committee's Secretary would be jointly responsible with respect to proposed market actions (or inactions). Under this arrangement, two men would determine whether proposed transactions or inactions were in accord with current Committee policy.

If this proposal is agreed to in principle, the modus operandi will develop as different types of situations are encountered. The essence of the proposal is that the Manager is to look to the Secretary for a check on his understanding of current Committee policy and whether proposed transactions would conform to that policy.

In all probability, the Secretary ordinarily would agree that the Manager's program of market transactions (or inactions) for the day is in accordance with the Committee's current objectives. In relatively few instances, the Secretary might doubt whether the program would conform to Committee policy. In that event, the Secretary and Manager would exchange views and generally would reach agreement upon a program for the day - either the Manager's suggested program or a modification.

In the rare cases when agreement could not be reached, the Manager nevertheless could act on his own initiative despite the contrary view of the Secretary. In such cases both men would summarize their reasoning in memoranda to the Committee members and would be prepared to discuss the incident at the next Committee meeting.

In case of basic disagreement regarding the advisability of transactions of substantial size and market importance - a contingency that might not occur once a year - either the Manager or the Secretary would have discretion to bring the matter immediately to the attention of the members of the Committee, for such action as the members might consider appropriate. In that rare event, an effort would be made to get in touch with all members of the Committee, and not merely the Chairman or the members located in Washington. If the problem seemed to be of sufficient importance, a special meeting of the Committee might be called to deal with it.

I have outlined these procedural details simply to show how the arrangement would work, but they are of relative insignificance. The chief value would lie in the increased responsibility of the Secretary as day-to-day interpreter of Committee policy and the benefit derived by the Manager from such regular and consistent checks upon the soundness of his operations. In other words, the program adopted by the Manager as a result of his discussions with the Secretary almost inevitably would be a program that represented the will and objectives of the Committee more effectively than if the Manager developed the program without such daily clearance with an official of equal responsibility in close touch with every phase of Committee thinking.

The suggested arrangement might strengthen the control of the Committee over the effectuation of its policies while preserving the benefits of management located in the prime money market. The functions of the two officers would complement each other, and our operations would benefit from the double check of the Secretary's intimate daily contact with Committee thinking and his detachment from direct concern with the practical problems of Open Market transactions, in addition to the benefit of the Manager's immediate and continuous knowledge of market conditions. It seems possible that a plan of this nature, modified and perfected by trial and error, might develop into an arrangement combining direct responsibility and control with practical and efficient operation, giving increased assurance that the will of the Committee is effectuated as precisely as possible.

The foregoing proposal would require the Secretary to devote all of his time to Open Market Committee matters. This seems clearly justified by the importance of our duties in the field of monetary regulation and the advisability of the closest and most efficient possible coordination of policy decisions with day-to-day operations. Consequently, the Secretary should be released from all other duties, although he would continue to be selected by the Open Market Committee from among the Board's employees and he would remain on the pay roll of the Board of Governors.

It may be said that a "two-headed" arrangement of this sort necessarily is clumsy or even unworkable. I am unable to concur in such objections. To be sure, one man in New York can make up his mind more rapidly than he and a colleague in Washington could reach a joint conclusion. However, the same argument could be made with respect to the Supreme Court, or the supervision of member State banks, or the deliberations of the Open Market Committee itself - each could be expedited if there were respectively one Justice, only one supervisor (State <u>or</u> Federal), or only one Governor or President at the head of the central banking system. Experience simply has shown that the less in "efficiency" that results from two or nine or twelve men doing what one <u>could</u> do (as a mechanical matter) is more than counterbalanced by the benefit of acting upon the composite judgment of a multiple-member organization, where the inevitable errors of any one man's thinking can be corrected and checked by the independent thinking of others.

Conduct of Open Market Operations of Federal Reserve System

1. Our basic position is that the Federal Reserve Bank in the principal national and international money market of the country, and the principal market for Government securities, should continue to be selected by the Federal Open Market Committee to execute transactions for the System Open Market Account, in accordance with policies and directives adopted by the Committee, and in behalf of all of the Federal Reserve Banks.

2. Our reasons for attaching the greatest importance to this position are:

   First, it is in accord with the federal character of the System and its general operating procedures. National credit policies are primarily determined by the Board of Governors of the Federal Reserve System and by the Federal Open Market Committee, and the execution of these policies is primarily the job of the twelve Federal Reserve Banks each operating in its own area. By reason of the financial structure of the country, the Federal Reserve Bank of New York is the natural and logical Federal Reserve Bank to execute open market operations for the Federal Open Market Committee.

   Second, it provides institutional responsibility as distinguished from individual responsibility for the proper execution of the directives of the Federal Open Market Committee. This means that the Manager of the System Open Market Account, in his supervision of open market operations, has the advantage of the active and continuous collaboration of the President of the Federal Reserve Bank of New York who is a member of the Federal Open Market Committee, of the First Vice President of the Federal Reserve Bank of New York who is an alternate member of the Federal Open Market Committee, and of his subordinate staff, all on an institutional basis.

   Third, it provides the natural and logical way of keeping under unified direction the various operations of the Federal Reserve System in the New York market, all of which contribute to the proper functioning of the System and to the success of its credit policies. All central banking operations in the New York market are interwoven - discount operations, Treasury operations conducted by the New York bank as fiscal agent, open market operations conducted for account of foreign central banks and governments, as well as open market operations for System Open Market Account. The money market is not made up of separate compartments and all of these various kinds of transactions need unified direction. It would be destructive of money market techniques and of the effectiveness of the New York bank, built up over the life of the Federal Reserve System, to introduce another arm of the System into the New York market, in the person of a separate Manager of the System Open Market Account.

Fourth, while it establishes a method of operations which is wholly responsive to the policies and directives of the Federal Open Market Committee, a statutory public body, it does not directly expose the operating arm of the Committee to those forms of political pressure, as distinguished from public responsibility, which can be destructive of the independence and operating integrity of our central banking system.

3. Having stated this basic position, we also recognize that the Federal Open Market Committee has a basic responsibility with respect to the selection and appointment of the Manager of the System Open Market Account, and that it is appropriate for the Committee to review its discharge of that responsibility. While the record of performance, and the absence of specific criticism of actions of the Account as it has been managed, suggest that the present method of selection and appointment of the Manager has worked well in practice, it may be possible to devise a procedure which will reflect more clearly the authority and responsibility of the Federal Open Market Committee with respect to that appointment, and thus abate internal dissatisfaction with present arrangements and ward off possible external criticism, political or otherwise.

4. To promote the mutual objectives of the Federal Open Market Committee and the Federal Reserve Bank of New York, it is suggested that:

(a) The Federal Reserve Bank of New York continue to be selected by the Federal Open Market Committee as the Federal Reserve Bank to execute transactions for System Open Market Account.

(b) Before appointing a Vice President of the Securities function of the Federal Reserve Bank of New York, which is the function which conducts open market operations, the directors of the Bank should consult with the Federal Open Market Committee, and there should be agreement between the Committee and the directors as to the appointment.

(c) The Federal Open Market Committee should then appoint the same individual as Manager of the System Open Market Account.

5. The lines of appointment to the dual job would then be clear, but the institutional responsibility of the Federal Reserve Bank of New York would be preserved and the destructive effects of having two arms or two representatives of the Federal Reserve System operating in the New York market would be avoided.

Nov 17, 1955.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date September 2, 1966

To Chairman Martin

From Mr. Holland

Subject:

CONFIDENTIAL (FR)

Attached is a copy of the preliminary draft of minutes of the meeting of the Federal Open Market Committee held on August 23, 1966. You will be advised of any changes made in the draft.

The minutes of the meeting of the Committee held on July 26 were approved in the form sent to you under date of August 11, 1966.

Attachment

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date September 2, 1966

To Chairman Martin

From J. Herbert Furth

Subject: Comments on The Fundamentals of a Free Enterprise Economy, by Stewart P. Coleman.

Mr. Coleman's paper represents an interesting attempt at reformulating both the theoretical basis and the practical consequences of "classical" economics. Mr. Coleman wants to reconstruct a perfectly free competitive economy--with "strict enforcement of the anti-trust laws" to avert "abuses by business in the monopoly control of goods and prices," and with the application of the anti-trust laws to labor and the enactment of a national "Right to Work" law to avert "upward pressure on labor rates resulting from labor monopoly," but without any other government intervention and especially without "government manipulation of fiscal policies" (page 72).

"Basic Fundamentals"

Mr. Coleman bases his model on the propensities to work and earn, to buy and consume, and to save and invest (page 1). He states two fundamental laws regarding those propensities: First, the proportion of the "working force utilized will vary with the economic variable of the real wages paid per unit of production"; and second, "as per capita real income rises, the proportion of that income going into consumption will become less and the proportion going into savings will become greater. The proportion going into savings will also tend to increase as the return to be expected from the investment of savings increases" (page 3).

Both these laws seem to conform to common-sense reasoning. Nevertheless, their validity is extremely doubtful.

Increases in "real wages" indeed may attract some non-working members of the potential labor force; but they may also induce some other members to quit work (e.g., wives of working husbands; children of working parents). In 1965, when the unemployment rate was 4.6 per cent, the U.S. labor force (relative to the adult population) was lower by one full percentage point than in 1958, when the unemployment rate was 6.8 per cent--although "real" wages (average weekly earnings per worker) had meanwhile risen by nearly one-fifth.

Unfortunately there is not the slightest evidence that the savings ratio rises with a <u>general</u> increase in real income or that higher returns on investment measurably increase the savings ratio.

Detailed investigation of savings trends in the United States over the past 100 years has failed to discover any significant permanent increase in the savings ratio, despite the rapid increase in per-capita real income. In 1965, for instance, the ratio of personal savings to disposable personal income was

5.4 per cent--exactly the same as in 1936; it was lower than in other peak years of postwar prosperity (7.1 per cent in 1948, 6.7 per cent in 1957) and only negligibly higher than in 1929 (5.0 per cent).

The failure of the savings ratio to respond to an increase in the national income has puzzled economists for a long time: individual experience clearly suggests that a substantial rise in real income leaves not only a larger absolute amount but also a larger proportion of income free for discretionary use, and thus also for savings. But a general rise in real income raises the standard of living rather than the savings ratio--probably thanks to the so-called demonstration effect, or in simpler language, to the desire to keep up with the Jones'. Luxuries become necessities (in my own lifetime, this has happened with car ownership, central oil heating, refrigerators, telephone, radio, television, water heaters, automatic washers and dryers, dishwashers, garbage disposals, and it is right now happening with foreign travel); and once these new luxuries are paid for, the proportion available for saving remains, for the average household, as small as before (even though the absolute amount has risen).

For these reasons alone, it is impossible to build a realistic model of economic society on the "basic fundamentals" chosen by Mr. Coleman.

The ratio of prices to wages

Another cornerstone of Mr. Coleman's edifice is "the ratio of prices to wages (the P/W ratio)" (page 8). Unfortunately, this ratio is neither as unambiguous nor as important as the author believes.

Actually, Mr. Coleman uses that ratio in three different senses, without clearly distinguishing between the different meanings.

First, the P/W ratio may be applied to an individual commodity; in this case, a decline in the ratio reduces the profit margin per unit of commodity but not necessarily the total profits of the enterprise (or of the economy as a whole) since the effects on total profits of the decline in the per-unit ratio may be offset by an increase in the number of units sold.

Actually, this type of P/W ratio has remained remarkably stable: some 40 years ago, Professor (now Senator) Douglas, on the basis of both theoretical reasoning and extensive statistical research, discovered his famous "law," according to which the proportion of returns to capital and to labor in industrial production tends to remain unchanged in the course of economic development; and the validity of this law has been well confirmed by later investigations.

Second, the P/W ratio may be applied to the movement of price and wage-rate indices. In this case, a decline in the ratio indicates a rise in "real" wage rates. This rise in wages may be associated with a fall in profits but alternatively--and more frequently--with a rise in profits since "real" wage rates tend to be the higher the greater the productivity of the economy and the greater therefore prosperity in general (including the profitability of enterprises).

For instance, between 1946 and 1965 this type of P/W ratio declined in the United States by about one-third as wage rates (adjusted for overtime and inter-industry shifts; otherwise the rise would have been even larger) rose by 140 per cent while wholesale prices increased 55 per cent and consumer prices 60 per cent. Over the same period, corporate profits (both before and after taxes) rose about 200 per cent. Clearly, neither "real" nor "nominal" profits were hurt by the decline in the P/W ratio and the corresponding rise in "real" wages.

Finally, the ratio may be meant to signify the relation between national income and wages. Subsuming all non-wage income under "profits," a decline in this ratio would indeed (by definition) mean a decline in the share of profits in the national income. But it again would not mean a decline in total profits

(Mr. Coleman should not be blamed for this confusion: both Ricardo and Marx apparently fell victim to a similar misunderstanding). For instance, between 1946 and 1965 the share of labor in total non-agricultural income rose from 70 per cent to 72 per cent; but this increase did not prevent "real" profits from rising about as rapidly as "real" labor income since the sharp increase in aggregate national income (which nearly doubled in terms of constant purchasing power) completely overshadowed the effect of the modest change in its composition.

Hence, Mr. Coleman is mistaken in believing that a decline in "the" P/W ratio would lead to a situation "where the incentive to save and invest would drop to a level where capital would be available only for the replacement of existing facilities but not for further expansion" (page 8). Since a large part of Mr. Coleman's reasoning is based on this belief (see his discussions on pages 15-19 and 47-50), his conclusions cannot be considered to be theoretically justified.

The role of credit

Contrary to classical economics, Mr. Coleman believes that the use of credit distorts the economy and is responsible for those economic ills that cannot be attributed to monopolistic behavior of business or labor.

Mr. Coleman views with understandable alarm the rise in total debt in the United States, from $191 billion in 1929 and $397 million in 1946 to $1,260 million in 1965. He believes that "a substantial mortgage has been placed on industry's markets which, at the same time, has greatly inflated consumer demand. Ultimate deflation of this demand will mean that industry will have over-invested in surplus capacity. The use of credit to finance capital expenditures . . . is not sound when resorted to by industry in general as a substitute source of capital for that which, in general, should preferably be generated from the operations of industry" (page 25).

There is a core of truth in the author's apprehension, especially as to the rise in consumer debt. But Mr. Coleman not only exaggerates the "burden on the overall economy" resulting from the increase in total debt; he also exaggerates the difference between equity and debt financing of business.

While the amount of debt outstanding in 1965 was indeed very large, it represented a slightly lower ratio to gross national product (185 per cent) than did the amounts outstanding in 1929 (186 per cent) or 1946 (190 per cent). It is quite true that a sudden liquidation of that indebtedness would have catastrophic consequences; but there is no inherent reason for such "deflation" to occur.

Moreover, the great bulk of that debt ($810 million) represented corporate, non-corporate business, farm, and mortgage indebtedness. These debts can be considered to be economically equivalent to "equity" participations (this reasoning was familiar to the medieval "schoolmen," who used it to defend the legitimacy of such credits against the condemnation of "usury"). The owner of an enterprise, farm, or building goes into "partnership" with the owner of liquid funds (in some common-law jurisdictions, the mortgage holder rather than the mortgagor is indeed considered to be the "owner")--with the only difference that the "partner's" share in the partnership's receipts and assets is a fixed sum instead of a ratio, and that the time of the dissolution of the partnership also is fixed (which incidentally could be the case in an ordinary partnership, too). It is quite true (as Mr. Coleman states) that these arrangements increase the "leverage" for the owner if profits are high and increase his risk if profits are low or nonexistent; but this merely means a change in the distribution of gain and loss between the two "partners," which is of little if any significance to the economy as a whole.

The situation is somewhat different in the case of the debts of the Federal Government ($270 million), State and local authorities ($93 million), and consumers ($87 million).

In the case of Federal, State, and local authorities, the contraction of debt can be understood as a modified form of taxation, which affects the distribution of the tax burden rather than its aggregate impact on the economy.

In the case of consumer credit, consumers may indeed be said to mortgage their future income for present rather than future consumption. But since most consumer debt is incurred in connection with purchases of consumer <u>durables</u> (such as cars), the transaction can also be interpreted as involving the promise of future payments for the <u>future</u> services to be derived from the continuing use of the commodity (in Britain, the legal fiction of "hire-purchase" is consistent with this interpretation).

Nevertheless, it is bothersome that consumer debt has recently been rising much faster than consumer income and consumer expenditures: that debt represented in 1965 about 20 per cent of consumer expenditures, as against little more than 8 per cent in 1929. But this reviewer has for some time been concerned about that development--which is clearly unsustainable in the longer run--without sharing Mr. Coleman's theoretical or practical views.

To sum up, there is no good reason for Mr. Coleman to conclude that the rise in debt has reduced "the internal generation of capital" (in 1965, undistributed corporate profits <u>plus</u> capital consumption allowances were a healthy $62 billion--in "real" terms about 3-1/2 times as much as in 1929, representing 9 per cent of GNP as compared with 7 per cent in 1929); that "the present high volume of production could have been achieved without incurring debt" (Mr. Coleman himself expresses the opposite opinion on page 25, where he concedes that "borrowing has been an important factor in the development of our economy"); that "with the above described increasing debt load the U.S. economy is in no position to withstand the impact of a recession"; or that there is danger of "the limit of borrowing capacity" being reached (page 26).

Government intervention

No objective observer can doubt that government intervention in economic problems at times hampers rather than promotes sustainable economic growth; the tendency to protect inefficient or obsolescent industries against domestic and especially foreign competition is a flagrant instance. But Mr. Coleman concentrates his attack on compensatory fiscal and monetary policies--exactly that kind of intervention that has been most consistent with the principles of a market economy and that has been most successful in practice.

Mr. Coleman believes that the "lowering of interest rates . . . through manipulation of government monetary and fiscal policies" results "in increasing the burden of interest cost to industry" and means "a regularly rising price level over the years as more and more debt is accumulated" (page 28). Actually, the "burden of interest cost" as a proportion of national income is less heavy today than it was before the advent of the "New Economics": net interest was equal to about 3-1/4 per cent of national income in 1965, as compared with 5-1/2 per cent in 1929. In the period 1946-53, it was less than 1 per cent of national income; the proportion is higher today mainly because after the Accord of 1951 monetary policies could again be used--in full accordance with classical economics--to raise interest rates in times of inflationary pressures.

The upcreep in prices is indeed bothersome; but it should be remembered that a tendency for prices to increase has been characteristic of prosperity long before the invention of the "New Economics." In the nine-year period 1898-1907--one of the most prosperous periods in U.S. history--consumer prices rose 27 per cent and wholesale prices 34 per cent (Historical Statistics of the United States, Series L 36 and L 15); in the nine-year period 1957-66, consumer prices rose 17 per cent and wholesale prices a mere 7 per cent. In those two periods the rise in total national income at current prices was quite similar: about 65 per cent in

1957-66, and about 67 per cent in the earlier period (Series A 154, extrapolated from data for 1899-1907). In "real" terms, the economic growth was thus substantially more rapid in the later period, and especially so on a per-capita basis since population rose 19 per cent in 1898-1907 (Series B 31) but only about 15 per cent in 1957-66. Apparently, under the "New Economics" economic welfare has improved more rapidly and at the cost of a considerably less rapid advance in prices than in the "gold old days."

Instead of the use of monetary and fiscal policies, Mr. Coleman recommends in a depression "the lowering of prices in relation to wages to increase consumption and eliminate inefficient production facilities" (page 31). But it was exactly this type of deflationary policies that became utterly discredited in 1929-33--and that had not worked very well in previous milder recessions--and therefore led to the emergence of the "New Economics." Clearly, there is no assurance that monetary and fiscal policies will always be able to avert catastrophes like the Great Depression; but their record over the past 20 years compares favorably with that of any other type of economic policy ever tried at home or abroad.

Labor policy

Mr. Coleman's attitude toward the labor problem is colored by his misconceptions about the importance of "the" P/W ratio.

Contrary to all available data, he believes that in consequence of the reduction in that ratio (meaning in this case the ratio between price and wage indices) "not enough capital is provided to maintain or expand production facilities" and "the share of the proceeds of production going to capital is so low that the extensive borrowing referred to above has been resorted to" (page 34).

Mr. Coleman attributes these (nonexistent) consequences of the decline in "the" P/W ratio to "labor monopoly." In his opinion, "the benefits of the increased productivity . . . are not allowed to accrue the overall public in the form of lower prices to increase overall production and total national real income . . . . Instead labor insists that it should receive the entire benefits of increased productivity . . . . Had the benefits of increased productivity . . . not been appropriated by labor our overall production today would be greater and distributed on a more equitable basis" (page 37).

It is difficult to recognize recent developments in the U.S. economy in this picture. Actually, the benefits of increased productivity--although in the form of increased money incomes rather than of reduced prices--have been shared by virtually all classes of the economic society. It is true that recipients of fixed incomes have been hurt by the price increase while the "active" members of the economic society, who receive variable incomes (profits, salaries, and wages), have benefited from the change. This inequality indeed creates hardship in individual cases, and it is one of the main reasons for demanding that economic policy be conducted in such a way as to avert even slowly creeping inflation.

But it should be remembered that creeping inflation is not exclusively attributable to "labor monopoly": there was no "labor monopoly" in the years preceding the First World War, when prices rose much faster than during the past nine years. Moreover, falling prices create far greater hardship for the far greater number of people (farmers, businessmen, home owners) who have to service a constant debt out of falling receipts. The period of falling prices that culminated in the recession of the 'nineties has--in contrast to the postwar period--not been one of the most prosperous and harmonious episodes of U.S. economic history.

Mr. Coleman is more justified in attacking the price creep for reasons of the U.S. payments balance. He rightly asks that "we restore in all segments of our economy the free unrestricted action of competitive forces so that we may reduce our costs of production to a basis where we can meet world competition" (page 73). It is not correct to say, however, that "this country is becoming more and more a high cost island," or that "our competitive costs disadvantage is further aggravated by excessive taxation and high interest costs as the result of government manipulation of fiscal policy" (page 67). Actually, in recent years prices and costs in the United States have risen considerably less than in most if not all other industrial countries; taxation in the United States has not been heavier than in most other industrial countries; and interest rates have been lower than in most of them.

Recommendations

Some of Mr. Coleman's recommendations are highly valuable. He rightly suggests "to reduce marginal unemployment (by) the training of marginally unproductive labor" (page 48). He rightly exhorts business to follow a policy of "low prices and low profit per unit rather than restricting volume to bring about high prices and unduly high profits which create idle capital and unemployment" (page 64). And he rightly warns labor "that raising wages above normal competitive levels by monopoly control can only result in inevitable inflation and unemployment" (page 74).

But the means Mr. Coleman recommends to achieve these purposes are of dubious value. It can hardly be expected that "the strict application of anti-trust laws" (page 75) will bring perfectly free competition to our basic industries (steel, aluminum, copper, automobiles, airplanes, railroads, airlines, TV networks, telephone, telegraph, electric power, oil, and many others). And even if it did, many instances would remain in which private gains and losses clearly deviate from social gains and losses: air and water polution are cases in point. Even if the most extreme form of the classical arguments for free enterprise is accepted, the scope of inevitable government intervention is much greater than Mr. Coleman seems to realize.

This is particularly true for fiscal and monetary policy. Mr. Coleman strongly objects to the present use of such policies but he does not propose an alternative. After all, money is, even according to the most extreme classical economists, a public rather than a private matter. Does Mr. Coleman advocate return to a quasi-automatic gold standard; or adoption of some automatic rule for money creation (as proposed by Professor Friedman); or return to the free private issue of bank notes (as in the period of "wildcat" banking)? He does not say.

Similarly, taxation is inevitably a public rather than a private matter, and every tax burdens some member of the community for the benefit of others. Does Mr. Coleman advocate a single strictly proportional income tax (as proposed by Professor Hayek), or exclusive reliance on indirect taxes (as apparently proposed by those who want to repeal the 16th Amendment), or levies on the States (as under the Articles of Confederation)? He does not say.

And what about boom and recession? Does Mr. Coleman want public policy to follow a strict laisser-faire policy in the hope that reasonable behavior of business and labor will avert all inflationary and deflationary danger? And if this hope is disappointed, what then? Mr. Coleman's suggestion to train sub-marginal labor shows that he is fully aware of the social implications of unemployment; does he wish to leave that problem to the uncertain mercies of private charity? He does not say.

There is only one point on which Mr. Coleman is explicit: his desire to make the anti-trust laws applicable to unions and to enact a national "Right to Work" law (page 75). In this instance, we are fortunately able to draw on extensive experience with the very legislation Mr. Coleman recommends.

Until quite recently, labor organizations in the United States were indeed subject to the "common law notions of conspiracy," and later to the Federal anti-trust law. The earliest attempt to exempt labor unions was made in the Nebraska Anti-Trust Act of 1897; and this attempt was "deemed unconstitutional favoritism when the law first came before a federal court sitting in Nebraska" (Frankfurter and Greene, The Labor Injunction, New York, 1930, page 138). The Sherman anti-trust act was applied by the courts to "combinations of labor" as early as in 1893 (Frankfurter and Greene, page 8).

That law was also used to pass prison sentences on labor leaders (e.g., on E. V. Debs in connection with the great Pullman strike of 1894, and on the mild and conservative Samuel Gompers as late as 1911; see Frankfurter and Greene, page 9).

The Clayton Act of 1914 was designed to put an end to the application of the anti-trust laws to labor, but this purpose was fully achieved only 19 years later, in the course of the New Deal legislation. Hence, until 1914 (and to a large extent in practice until 1933), the anti-trust laws were indeed made applicable to labor unions.

Similarly, the "right to work" was fully supported in that period. In fact, the right to strike, or even to union membership, was denied. A Federal statutory provision as well as State laws prohibiting discrimination against union members was declared unconstitutional by the Supreme Court in 1911 and 1914, respectively (Adair v. United States, 208 U.S. 161; Coppage v. Kansas, 236 U.S. 1). Even after the passage of the Clayton Act, the Fourteenth Amendment was used to support court action against strikes, and a State law prohibiting such action was declared unconstitutional by the Supreme Court in 1921 (Truax v. Corrigan, 257 U.S. 312).

It cannot be said, however, that labor relations in that period were ideal. Strikes were not only numerous--as evidenced by the large number of "labor injunctions" listed by Frankfurter and Greene (Appendices I - III)--but also tended to be violent--as evidenced not only by a number of notorious incidents involving strikers, professional strikebreakers, and security forces, but also by the emergence of the radical and even anarchistic Industrial Workers of the World in 1905.

Even today, "right to work" laws are in effect in a number of States. If there is any evidence that these laws have served to keep wages in those States closer to the level that would be reached in a perfectly free labor market, or in any other way to make labor relations in those States more harmonious or economic development more rapid, the advocates of a national "right to work" law have been strangely silent about it. Or if there is any evidence that these laws have seriously diminished the legitimate status and power of labor, the opponents of a national "right to work" law have been equally silent about it. The conclusion to be derived from this mutual silence is that a national "right to work" law would neither significantly help management nor significantly hurt labor--in short, that it would not significantly affect the economy and that the issue is therefore irrelevant.

To sum up, it seems unlikely, to say the least, that a return to the pre-1914 legal status would result in a free competitive labor market. Legislative action might outlaw "monopolistic" labor unions; but it could no more assure truly equal and free bargaining between an individual worker and General Motors than it could establish meaningful free competition between General Motors and a mechanic trying to build an automobile in his backyard.

Conclusions

The main reason for Mr. Coleman's failure to establish a valid theoretical basis for economic policy is to be found in his method of making general abstract statements and then deducing from these statements concrete policy recommendations.

In doing so, Mr. Coleman is in good company--though not in the company of the Founding Fathers of classical economics, Adam Smith and Malthus, who were careful to base their theories on thorough factual research. But like so many others, Mr. Coleman seems to forget that economics--in contrast to mathematics--is an empirical science, and that its laws can therefore be derived only from an analysis of actual experience.

Experience has shown that economic reality is less simple than Mr. Coleman seems to assume, and even less simple than it was at the time of Smith and Malthus. Mr. Coleman believes that nothing more is needed to achieve optimal economic behavior of business and labor than stopping government intervention. Actually, the relevant question is not whether or not there is need for government intervention in the economy but where, when, and how the government should intervene--just as in modern city traffic control the problem is not whether or not there is need for traffic lights and traffic police but where, when, and how traffic lights and traffic police should operate.

The "New Economics" has become an important force in economic policy because, whatever its shortcomings, it has at least recognized this basic truth. It can and will one day be replaced by a better system of economic policy--but only after its opponents become willing to base their reform proposals on analysis of actual experience rather than on an imagined world of perfect human behavior.

JHF