

William McChesney Martin, Jr., Papers

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Series V, Subseries A

FRB Official memos, 1957-60

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

ROUTE SLIP - Date 4/23/57

To Chairman Martin

From Raymond J. Collier
Edwin J. Swindler

- | | |
|--|---|
| <input type="checkbox"/> For your information | <input type="checkbox"/> For attention |
| <input type="checkbox"/> Note and return | <input type="checkbox"/> Preparation of reply |
| <input type="checkbox"/> Note and forward to Files | <input type="checkbox"/> Phone me re attached |
| <input type="checkbox"/> As requested | <input type="checkbox"/> See me re attached |
| <input type="checkbox"/> For your comments and suggestions | <input type="checkbox"/> Does attached meet with your approval? |

Other remarks: The attached memorandum is being sent to you at Governor Mills' request.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 4, 1957

To Governor Mills
From R. J. Collier and E. J. Swindler

Subject Free reserves and Federal Open
Market Account, actual and
under three assumptions.

This refers to your request that consideration be given to what might be the effect on the level of "free reserves" of conducting Federal open market operations by (1) ignoring fluctuations in float or (2) basing them on changes in required reserves alone.

In order to compare actual free reserves and the open market account with hypothetical free reserves and open market account under certain assumptions described below, weekly average figures of factors affecting member bank reserves were compiled for the period August 29, 1956 through January 30, 1957. This period was chosen because the wide fluctuations in reserves that normally occur during the period would provide a good test of given alternatives. The weekly averages used in these comparisons are the final reported figures, some of which did not become available until two to four weeks after the end of the given period; they were not available to the Federal open market account manager, who had to make his decisions on the basis of forecasts and day-to-day market developments. Use of the final actual figures in these comparisons eliminates the adverse effect of poor forecasts; it seeks to show how the open market account might have moved if the related factors had been so well forecasted every day as to result in a weekly average that coincided perfectly with the final reported average.

Comparisons of actual free reserves and the Federal open market account are made with hypothetical figures computed under the following three assumptions:

- (1) That all changes in factors affecting free reserves except those due to float are offset by open market transactions.
- (2) That free reserves are held constant, i.e., that all factors are offset by open market operations.
- (3) That open market transactions are based on the movement of required reserves.

The results are reflected in the accompanying charts.

Situation under Assumption 1. Had open market transactions offset all changes in all factors affecting free reserves except those in float, the System account would have been about as stable during September-November as it actually was. Thereafter, as Chart 1 shows,

it would have risen to a high of over \$25,800 million in the week of December 26 and declined to \$23,400 million in the week of January 30, a range of \$2,400 million. The actual range of movement in the open market account during the same period was about \$1,500 million, from \$24,966 million to \$23,480 million.

Increases in float which supplied reserves in December, and decreases which drained reserves in January, tended to reduce the need for open market operations. If movements in float had been ignored, free reserves would have shown somewhat wider fluctuations in September-November and very much wider fluctuations in December-January than actually occurred, as Chart 2 shows.

Situation under Assumption 2. If free reserves could have been held constant and the open market account had been adjusted to all other factors, including float, the account would have fluctuated more than it actually did during September-November. In December-January, the account would have risen to a high of \$24,800 million in the week of January 2, and declined to a low of \$23,100 million in the week of January 23, a range of \$1,700 million. This range was similar to the actual range of \$1,600 million in January, from a high of \$25,100 million on January 2 to a low of \$23,500 million on January 30.

Situation under Assumption 3. For this assumption we first adjusted the open market account average for each week by an amount sufficient to bring free reserves to a constant level, and for this purpose we chose the level (negative \$427 million) that existed in the first week of the period;^{1/} we then computed for each week the ratio of required reserves to the adjusted open market account; and finally we computed an average of this ratio for the four weeks ending with each week in the test period. This moving average ratio was used in deriving the open market account for the next week--simply by applying the ratio to required reserves in the next week.

If open market transactions had been conducted in this manner, the open market account would have varied more in the period September-November than it actually did. The timing of changes prior to December tended to be opposite to that of the actual account as Chart 1 shows. Variation during December and January would have been somewhat smaller than it actually was. The account would have risen to a peak of \$24,700 million in the week of January 2 and declined to \$23,300 in the week of January 30--a range of \$1,400 million. The actual change in this period was from \$25,100 million to \$23,500 million--a range of \$1,600 million.

^{1/} The percentage relationship between required reserves and open market account as thus adjusted for a constant level of free reserves was used on the grounds that a relationship of this sort would tend to reflect better the aims of the Federal Open Market Committee.

To: Governor Mills

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Under this assumption free reserves would have shown substantially larger week-to-week changes than actually occurred and would have been negative almost throughout the period. In each month September-November free reserves would have fluctuated very widely, reaching high negative levels at mid-month and declining sharply in weeks ending the 19th-24th accompanying intramonthly increases in float. Free reserves would have fallen during early December to a negative level of nearly \$900 million by mid-month, and then risen sharply during the last half of the month. In January free reserves would have averaged higher, but would have shown about the same range of movement as in the preceding months. Hence, throughout the period a four-week moving average percentage relationship between required reserves and the open market account was not sufficiently sensitive to prevent substantial seasonal changes in reserve balances and free reserves resulting mainly from variations in float.

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Since it has been the policy of the Open Market Committee to maintain free reserves within a limited range in order to prevent wide fluctuations in interest rates which would disrupt the money market, it appears that actual open market operations during the period reviewed were more conducive to effectuating its policy than would have been operations under any of the three assumptions.

This does not preclude the possibility that generally satisfactory results could be achieved if the Open Market Committee ignored float except when very wide changes therein were indicated -- but it would be very difficult, of course, to forecast when changes in float would be so wide as to require compensating open market operations. Although precise forecasts of changes in float cannot be made, the direction of movement from week to week is generally predictable, and some offsets by open market operations seem to be preferable to none at all.

To conduct open market operations on the basis of estimated changes in required reserves alone would not seem to be conducive to an orderly market, partly because country bank required reserves can not be estimated satisfactorily, but principally because changes in free reserves reflect changes in reserve balances much more than they do changes in required reserves.

CHART 1
 Behavior of Federal Open Market Account, Actual and Under Three Assumptions
 Averages for weeks ended Aug. 29, 1956 to Jan. 30, 1957

Millions of dollars

Millions of dollars

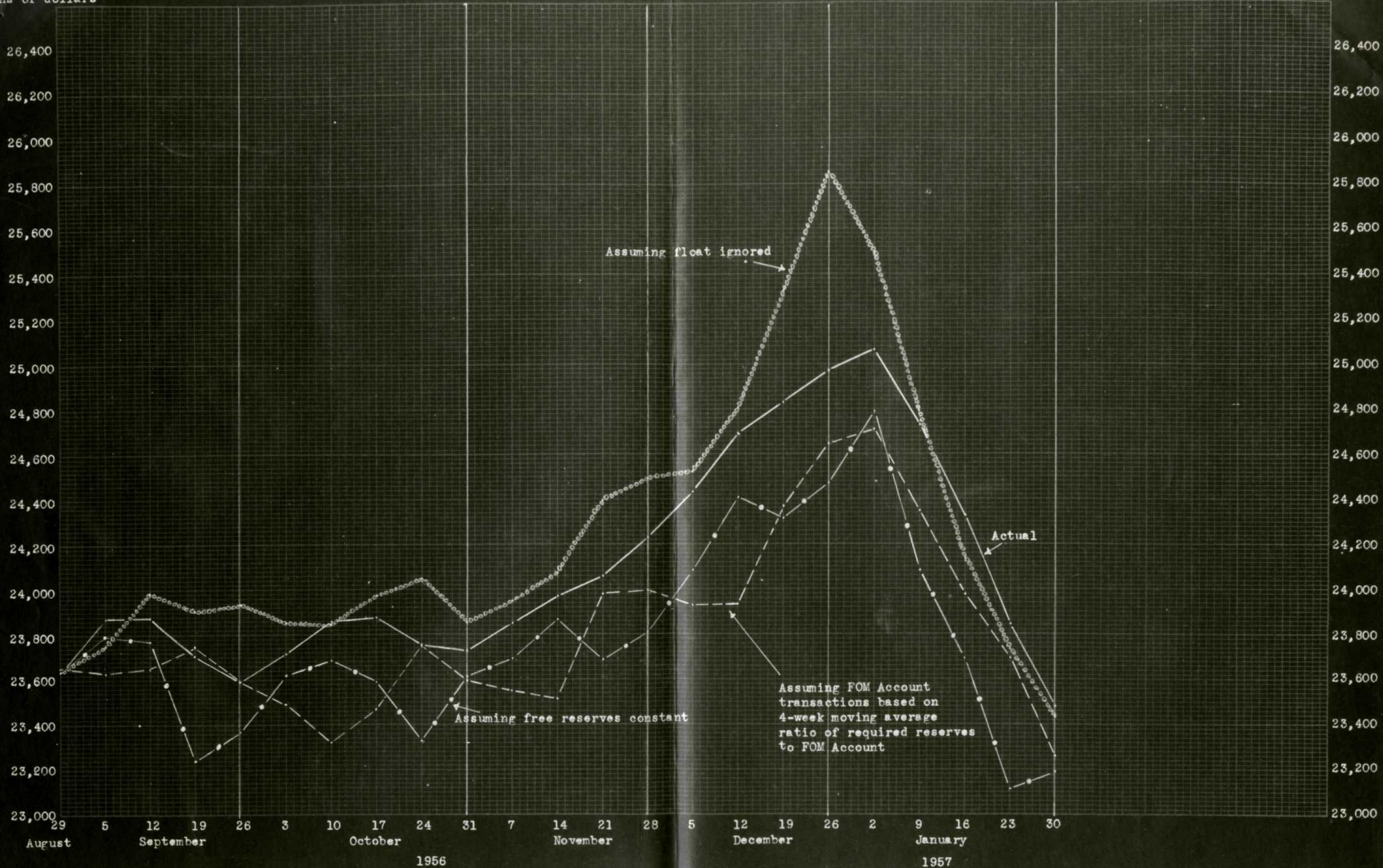
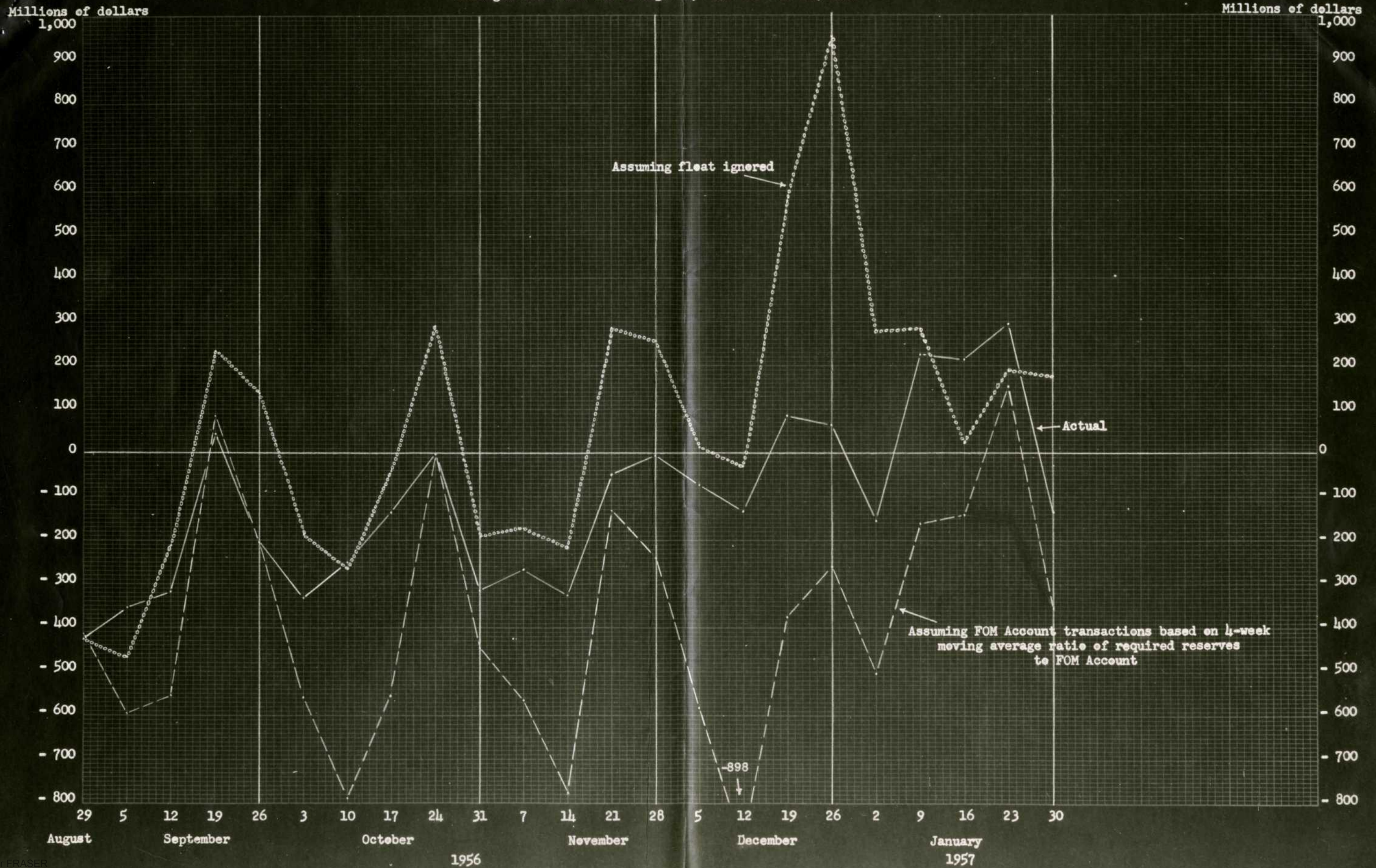


CHART 2
 Behavior of Free Reserves, Actual and Under Two Assumptions
 Averages for weeks ended Aug. 29, 1956 to Jan. 30, 1957



CONFIDENTIAL

Memorandum on Problems Arising in Connection with
the Discount Rate Reduction of November 14, 1957

The circumstances of the reduction in the discount rate of the Federal Reserve Bank of New York and three other Reserve Banks on November 14 were disturbing to the directors of this Bank in two respects: (1) the part played by the Board of Governors in connection with the discount rate change, and (2) the questions raised by the recent experience with respect to the relations between the System and the Treasury.

For several months it had been the opinion of the directors of this Bank that business prospects for the latter part of this year were not as strong as commonly thought, and that a revival of inflationary boom conditions was unlikely. In this appraisal the officers of the Bank concurred. For this reason the directors were reluctant to raise the discount rate in August -- an action which, however well justified by developments in market rates, including the advance in the commercial bank "prime loan" rate, could be interpreted as a further step in the direction of intensification of credit restraint. Nevertheless, after several of the other Reserve Banks had acted to raise the discount rate and there was evidence that distortions in the interdistrict flow of funds were developing because of the rate differential between this and other districts, the directors voted to raise this Bank's discount rate.

At the same time the directors expressed the view that seasonal needs for reserve funds should be met promptly through open market operations, rather than permitting such needs to cause further pressures on bank reserves and possibly interfering with the financing of normal seasonal activities. Again the officers of the Bank concurred, and Mr. Treiber and Mr. Hayes presented this view at meetings of the Federal Open Market Committee, beginning with the meeting

of August 20. Apparently the Committee was reluctant to take any action which might be interpreted as indicating relaxation of the System's policy of credit restraint. As the fall season progressed, it became increasingly clear that business activity, at best, was showing no more than the usual seasonal revival of activity and might be falling somewhat short. Business loans at reporting member banks were clearly lagging, and in October showed a contra-seasonal decline. In these circumstances, the officers and directors of the Bank felt that the reduced loan demand should be permitted to be reflected in somewhat easier member bank reserve positions and in money market conditions.

By early November it was clear that seasonally adjusted indexes of production and trade had turned down and that indexes of wholesale and consumer prices were leveling off, and a change in Federal Reserve policy appeared to be called for. It was the view of the officers and directors of the Federal Reserve Bank of New York that an appropriate way to effect such a change in policy would be to use open market operations to ease member bank reserve positions and money market conditions gradually, and to follow up with a discount rate reduction after a few weeks if economic conditions and money market and credit developments then made such a clear-cut confirmation of a change to a less restrictive policy appropriate. This procedure, we believe, had considerable support throughout the System, although an immediate discount rate reduction was favored by a few. Presumably open market operations would have led the way in a change of policy had it not been for the intervention of the Treasury, which was about to announce the terms of its December refunding and new money borrowing operations.

The Secretary and Undersecretary of the Treasury, upon being informed of the System's intention to effect a change to a somewhat less restrictive policy over ensuing weeks, took the position that that information placed them in an

untenable position. They argued strongly that it would be improper for them to announce financing terms in line with then prevailing market conditions, when they knew that a change of Federal Reserve policy had been decided upon, and that it would be impossible to conduct their financing operations successfully if the terms of the offerings were adjusted to the market conditions that might be expected to prevail after the change in System policy had become effective. The first suggestion was that public announcement be made of the change in System policy, but it was concluded that such an announcement was not feasible and would be contrary to established Federal Reserve practice and policy.

This left as the only available means of System action to make the change of System policy promptly and widely understood either a reduction in the reserve requirements of some or all member banks, or a discount rate reduction. The Board of Governors did not favor the former at this time, and the Chairman of the Board undertook to discuss with the Reserve Bank presidents the question of an immediate reduction in the discount rate. Not only was consideration of a discount rate reduction suggested, but the precise amount of reduction favored by the Board was indicated. In fact, it was implied that no other discount rate change would be approved, and the force of this implication was demonstrated when the Board refused to approve a lesser reduction voted by the directors of the Federal Reserve Bank of New York.

There are two aspects of this experience that are disturbing: (1) the steps taken by the Board, as a result of Treasury representations, to induce hasty action by Reserve Banks contrary to that favored by a majority of Reserve Bank presidents as the result of orderly procedures and consideration only a day or two earlier; and (2) the action taken by the Board virtually to dictate the amount of discount rate change to be made by the Reserve Banks. The latter was of particular concern to the directors of the Federal Reserve Bank of New York.

While, as indicated above, our directors were — and had been for some time — in favor of a shift to a less restrictive credit policy in view of their appraisal of the economic situation, they would have preferred that the initial action take the form of open market operations to ease the pressure on bank reserves. Nonetheless, when it became clear that one or more of the other Reserve Banks would reduce the discount rate, they felt that it would be undesirable for the New York Reserve Bank to stand aloof, having in mind its location in the principal financial center and its conviction that credit policy should be eased. Having once reached this decision, they concluded, however, that a reduction of $1/4$ per cent would be most appropriate for this Bank, for a variety of reasons. Even assuming that some overt signal of the change in Federal Reserve policy was needed to meet the views of the Treasury, a $1/4$ per cent reduction would have served the purpose. It would also have run less risk of suggesting to the public that the directors were alarmed over the business outlook, and would have involved less dislocation in the financial markets. Even though our directors were informed that the Board would prefer a reduction of $1/2$ per cent, they were shocked when their action in voting the smaller reduction was disapproved by the Board, leaving them only the choice of "all or nothing".

There is always room for judgment as to how much of a rate change is appropriate to the circumstances, and perhaps in the end we may conclude that the larger reduction was desirable. But an important matter of principle was involved — the statutory allocation of initiative and responsibility among the component parts of the Federal Reserve System, with its "checks and balances" which constitute one of the System's greatest elements of strength. Responsibility for initiating discount rate action is placed upon the Reserve Bank boards of directors, and should be permitted to function as far as possible if the recognized advantages of a regional system are to be preserved. It would be most unfortunate

if an impression should be created that, in this or other areas of responsibility of Reserve Bank boards of directors, the judgment of the directors was likely to be overruled by the Board of Governors without giving full weight to the directors' judgment after a careful exchange of views.

Aside from the particular incidents that arose in connection with the recent discount rate action, the experience raises important questions concerning the influence to be exerted on System policy decisions by Treasury financing operations. Even though the System for several years has ceased giving direct support to Treasury financing operations (except for one occasion on which the Treasury had a serious problem and direct support could be given without interfering with the System's policy objectives), there has been general agreement on a policy of maintaining a reasonably "even keel" in the money market during periods of Treasury financing. But it has not been felt that Treasury operations should be permitted to interfere with the orderly determination and execution of Federal Reserve policy. While the System has avoided action to intensify pressures on bank reserves during the period from the first announcement of a Treasury financing operation until the operation had been consummated, it has not suspended at such times consideration of, or decisions concerning, any change of Federal Reserve policy that appeared to be appropriate in the light of all the circumstances then prevailing.

Unavoidably this has meant on several occasions, during the application of a restrictive credit policy for the past two years and more, that System action to resume pressures on bank reserves after a Treasury financing operation had been consummated caused prices of the newly issued securities to fall below par. Similarly, in the recent instance, if the policy agreed upon on November 12 had been carried out without change, no action to reduce the pressure on bank reserves would have been taken during the period in which the Treasury financing operations were being carried out, but subsequent open market operations might have caused prices of the new Treasury issue to rise well above par.

It can be argued that System action during a period of increasing credit restriction, without prior notice to the public of its intentions in each instance of Treasury financing, was unfair to subscribers to new Treasury issues; and that to have proceeded with the policy agreed upon on November 12, without prior notice to the public, would have given the subscribers to the new Treasury issues a "windfall" profit and would have been unfair to the Treasury. But acceptance of this argument would mean that there would have to be a hiatus in System policy decisions (unless accompanied by an announcement or by some overt action) every time a Treasury financing operation was in prospect, extending probably from two or three weeks prior to the first announcement of each offering until some time after the operation had been completed. When there were frequent Treasury operations, as there have been in recent months, this would leave little time for the consideration and execution of effective and timely Federal Reserve policies.

It seems to us, therefore, that a dangerous precedent has been set if the System is to be precluded from adopting policy changes without immediate public notice in some form if, at the time, the Treasury is approaching a refunding or cash financing operation. In any event, it seems clear that this is a subject that should have careful and full consideration by the System before another similar situation arises.

Federal Reserve Bank of New York
December 2, 1957

C. DISTRIBUTION WITHIN THE FEDERAL RESERVE SYSTEM OF AUTHORITY ON CREDIT POLICIES

15. Trace the historical development of the process by which the discount rates of the Federal Reserve Banks are set and evaluate the relative authority of the Board of Governors and of the directors of the Federal Reserve Banks in setting discount rates today.

Development of process by which discount rates are set.—When the Federal Reserve Act was enacted in 1913, discount rates were regarded as the principal instrument of credit policy. Since that time, discount rates have come to be supplemented by other instruments of credit policy, notably by open market operations and the authority to change reserve requirements of member banks but also by regulation of stock market credit and at special times by regulation of consumer and real estate credit. Today, it is recognized that the process of influencing bank credit expansion is complex and that the instruments or combination of instruments most appropriate to the task will vary at different times according to the changing factors and forces affecting the growth of bank and other credit. Moreover, since the establishment of the System, far-reaching changes in the character of the economy, deriving from two world wars and basic developments in communications, transportation, mass production, business organization, and public policy, have worked to alter the fundamental structure of the credit market. Over this period the credit market has shifted from a structure of interconnected local and regional markets into a relatively well-integrated national market, with borrower rates of interest for financing of a given amount and comparable risk in closer alignment as between various localities and regions. With these changes, local and regional differences which might be reflected in differences in discount rates have diminished in importance and the rates have come to reflect more and more conditions in the nation as a whole. These modifications in the role and interrelation of regional discount rates have substantially affected the procedures by which the rates are fixed.

The present statutory authority for the fixing of discount rates is substantially the same as it was when the Federal Reserve System was established. Section 14 (d) of the original Federal Reserve Act provided that :

Every Federal Reserve Bank shall have power :

(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business; * * *

It seems clear that the framers of the Act contemplated that the authority to establish discount rates would be vested primarily in the directors of the several regional Federal Reserve Banks, but that the final determination of the rates would be in the Federal Reserve

Board. Thus, in explaining this provision of the Act on the floor of the Senate, Senator Owen stated:

* * * This power primarily is placed in the hands of the Federal reserve bank directors; but the final determination of the rate is put in the hands of the Federal reserve board, * * *

The Federal reserve board has the right, finally, to fix the rate of interest, for instance. The local board first fixes the rate of interest, and then it is subject to review and order by the Federal reserve board. It would be an order within which the board of directors or officers of such bank would act. (Cong. Rec., Vol. 50, Nov. 24, 1913, p. 5996, Vol. 51, Dec. 13, 1913, p. 859)

Before the opening of the Federal Reserve Banks for business on November 16, 1914, the Board requested the chairmen of the boards of directors of the Federal Reserve Banks (who were also designated by the law as Federal Reserve Agents) to indicate their views as to what rate of discount it would be wise to establish at the beginning. On the basis of reports received from the Reserve Banks, the Board voted to fix the initial rates at from $5\frac{1}{2}$ percent to $6\frac{1}{2}$ percent. In advising the Reserve Banks of this action, the Board stated that it had "felt it incumbent to adopt a moderately conservative policy in view of the fact that the exact conditions to which the banks will be subjected in operation cannot be precisely foretold", but pointed out that the initial rates were to be regarded "as provisional and subject to revision" and that the Reserve Banks had the right, with the approval of the Board, to change the rates at any time.

In keeping with the importance initially attached to discount rates, somewhat elaborate procedures were established in the early years for the fixing of such rates. At the Federal Reserve Board, there was set up a "discount committee" which met each Wednesday to consider discount rates prior to a meeting of the full Board on Thursday. Effective January 1, 1915, a procedure was established under which the Reserve Banks were asked to submit their recommendations for changes in discount rates in time to be considered by the Board's discount committee each Wednesday afternoon. A form was prescribed by the Board for use by the Reserve Banks in submitting their weekly reports, at first by mail and later by code telegrams. However, in March 1920, after it had been found that the Board's discount committee was unnecessary, the practice of requiring weekly reports from the Reserve Banks was discontinued and they were asked to advise the Board only when changes in rates were being recommended.

At an early date, a practice developed under which the Board, usually after discussion of the matter with the Federal Advisory Council, suggested to the Federal Reserve Banks the desirability of changes in discount rates; and ordinarily the Reserve Banks would promptly establish the desired rate subject to the Board's approval. Only rarely were rates fixed by the Reserve Banks later disapproved by the Board because of considerations of national policy. For example, in late 1919, when one of the Federal Reserve Banks voted to increase discount rates, the Board withheld its approval because the Treasury Department felt that such an increase in the discount rate would adversely affect the Treasury's program for marketing Liberty Bonds and Victory Notes. However, when the financing program of the Treasury was completed, the increase in rates requested by the Federal Reserve Bank was approved by the Board.

It was in connection with this case that Carter Glass, then Secretary of the Treasury and ex-officio member of the Board, requested the opinion of the Attorney General of the United States as to the authority of the Federal Reserve Board to initiate discount rate changes if it so desired. In an opinion dated December 9, 1919, the Acting Attorney General of the United States ruled that the Board—

has the right under the powers conferred by the Federal Reserve Act, to determine what rates of discount should be charged, from time to time by a Federal Reserve Bank, and, under their powers of review and determination, to require such rates to be put into effect by such Bank. (32 Op. Atty. Gen. 81, 84)

During the period of and immediately following the First World War, there was considerable use by member banks of the discount facilities of Federal Reserve Banks and there were frequent changes in discount rates. In an effort to curb credit and monetary expansion during this period, the Board recommended and Congress enacted on April 13, 1920, an amendment to section 14(d) of the Federal Reserve Act to authorize the establishment of graduated discount rates based on the amount borrowed by a member bank. The graduated rates authorized by this amendment soon proved to be impracticable and by an Act of March 4, 1923, section 14(d) was again amended to restore it to its original form.

Although the Board had requested the Federal Reserve Banks in 1914 not to announce any changes in discount rates until approved by the Board, it appears that on several occasions some of the Reserve Banks had publicized rate changes before the dates on which the changes were to become effective. Consequently, the Board, on August 22, 1924, adopted regulations designed to insure the confidentiality of information relating to prospective changes in discount rates. In brief, these regulations provided that all telegraphic communications regarding rate changes be in code; that no information with respect to rate changes be published until the Federal Reserve Bank in question was advised that the change had been approved by the Board; that announcements of rate changes be made simultaneously by the Federal Reserve Bank and the Federal Reserve Board immediately after the close of business on the day on which the rate was approved; and that the new rate be effective at the beginning of the first business day following the day on which the announcement of the change was made.

During the early twenties open market operations of the Federal Reserve Banks became increasingly important as an instrument of credit and monetary policy and it was recognized that use of that instrument should be coordinated with the use of the power to fix discount rates. As evidence of this fact, the Federal Reserve Board, in November 1925, requested the Federal Reserve Banks to report not only changes in the regular discount rates, but also buying rates on bankers' acceptances and on Government securities bought under resale agreement. The expanded reports were required to be made by telegraph following each meeting of the board of directors of each Federal Reserve Bank, indicating the action taken by the directors, either in approving continuance of the existing rates or in recommending any changes therein.

The principal procedural development during the thirties was the amendment of section 14 (d) by the Banking Act of 1935 to re-

quire that discount rates be established "every fourteen days, or oftener if deemed necessary by the Board".

As pointed out in the answer to Question A-1, one of the provisions of the Banking Act of 1935 required the Board to keep a complete record of all of its actions of policy and to include in its annual report to Congress a full account of all such policy actions. In view of this requirement, the Board requested the Federal Reserve Banks to include in their telegrams recommending changes in discount rates a definite statement in each case of the reasons underlying such action. It was made clear, however, that such a statement of reasons ordinarily would not be included in a telegram merely advising the Board of establishment without change of pre-existing rates.

During recent years no important changes have been made in the procedure for setting discount rates. However, as the result of the growing national character of the credit market, the recognized close interconnection between discount rates, open market operations, and changes in reserve requirements, the supplementary though subordinate role in national credit policy of selective credit regulation, and the significantly greater part which Government securities have come to have in the asset structure of banks and other lenders, it has become general practice for the Federal Reserve Banks to act uniformly in fixing discount rates and to give special consideration to their relation to other instruments of credit and monetary policy and to their effects upon the market for Government securities. For example, in October 1942, after considerable previous discussion with the Presidents of the Federal Reserve Banks, the Board approved the establishment at all Federal Reserve Banks of a uniform preferential discount rate of one-half of 1 percent for advances to member banks collateralized by Government securities having maturities of one year or less. This action was taken in support of the Treasury's war financing program and was designed to encourage banks to invest more of their excess reserves in short-term Government obligations. Subsequently, after the end of the war, the preferential rate on advances secured by such short-term Government securities was eliminated by all of the Federal Reserve Banks after considerable advance discussion within the Conference of Presidents of the Federal Reserve Banks, as well as by the Federal Open Market Committee, and with the Secretary of the Treasury. These actions were approved by the Board.

At the present time, the procedure for the setting of discount rates, as it has evolved over the years, is generally as follows:

Each Friday the Board considers all actions taken by the Federal Reserve Banks during the preceding week to establish discount rates, usually action to re-establish the existing rates. The possible desirability of any prospective change in discount rates is usually considered in advance by the Board with the Presidents of the Federal Reserve Banks and the Federal Open Market Committee in the light of changing credit conditions, including the Government's financing needs and current trends in the economy generally. Whenever it is determined that as a matter of policy there should be a change in rates, action to establish such a change usually is taken uniformly by the boards of directors (or executive committees) of the several Federal Reserve Banks at their next meetings following such determination. Thus, in August 1950, after consultation between the Board and the Federal Open Market Committee, as one measure for restrain-

ing credit and monetary expansion, a discount rate of $13\frac{1}{4}$ percent—initially proposed by the Federal Reserve Bank of New York—was established at all of the Federal Reserve Banks and that rate prevailed at the end of 1951.

In accordance with the procedures established many years ago, as previously indicated, whenever discount rates are changed, the action is announced simultaneously by the Board and the Reserve Bank at the end of the day on which the Board acts and the new rates are made effective on the next business day following the day of the announcement.

Relative authority of the Board and the Federal Reserve Banks.—The law clearly contemplates that the establishment of discount rates shall involve joint action by the Federal Reserve Banks and the Board of Governors of the Federal Reserve System. It is also clear that rates established by the Reserve Banks shall not become effective until approved by the Board of Governors. Since prospective changes in rates are ordinarily discussed in advance between the Board and the Reserve Banks, it is only rarely that action taken by a Federal Reserve Bank for the setting of discount rates is not promptly approved by the Board. On occasion, however, the Board may fail to approve or defer its approval pending discussions of System credit and monetary policies and Treasury financing policies with the Presidents of all Federal Reserve Banks or with the Federal Open Market Committee. The matter is usually discussed also with the Secretary of the Treasury.

Since the Board's authority is not limited to mere approval of rates established by the Reserve Banks, but includes power to review and determine such rates, the Board, as previously noted, has legal authority to initiate discount rates. However, methods evolved through experience for the taking of action on discount rates are calculated to avoid the development of procedural issues in this respect.

Discussion of the relationships of discount and other credit policy is given in the answer to Question C-18.

Bills Only PolicyArgument

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

Comments

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

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

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

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

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

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

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

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

C. M.

For internal use only

A memorandum to the
Board of Governors

CONCERNING
UNDERSTANDING

Sept. 23, 1960

C. M.

Members of the Board

Charles Molony

"Means by which the policies and actions of the Board can be made more widely understood."

The basic ingredients of any program for promoting understanding of the Board's policies and actions would have to be:

1. Immediate explanation of every action in the press release announcing it.
2. Follow-up explanation amplifying what has already been said and enlarging on the perspective. The Bulletin is the best instrument for this as a rule. 1?
3. "Position Paper" or "White Paper" treatment of matters of strategic importance: i. e., subjects or theories in debate in parliamentary, academic and popular quarters that have a vital bearing on the task of the Federal Reserve and its ability to carry out that task.

Everything else would have to be built around this base. Depending on how intensively the Board wished to proceed, the effort could include anything from private interviews to television appearances. But these would need to be timely and opportune rather than regular.

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I The Immediate Explanation

In monetary matters -- in contrast to supervisory and regulatory matters -- the Board already offers some explanation of action at the time it is announced.

To show where problems do and don't exist on a consequential scale, "immediate explanations" will be discussed here by type of action.

a. Reserve Requirement Changes

Least problematical is the reserve requirement instrument.

Almost always since the Board has had authority to vary reserve requirements, some degree of explanation has been offered in the press release announcing an action.

That was true of the most recent action related to reserve requirements, the action announced August 8, 1960. The explanatory matter was briefly but prominently stated in the second paragraph:

"The changes (being announced), made in further implementation of a 1959 Act of Congress relating to vault cash and reserve requirements, will make available about \$600 million of additional reserves for expanding bank credit as the economy enters the season of rising credit needs."

Is this case or does it merely free the Desk from supplying seasonal needs?

Two further sentences of explanatory character were placed in the fifth paragraph, relating them to the item of action for which explanation was being offered. This is what they said:

"This change (reduction in reserve requirements of central reserve city banks to 17 1/2 per cent) is a first step toward compliance (underscoring added) with a provision of the 1959 Act that the differential between the requirements of central reserve city and reserve city banks be eliminated by

July 28, 1962. Since the requirement for banks in reserve cities is now 16 1/2 per cent, the present action reduces the differential from 1 1/2 percentage points to 1 point."

Not a lengthy explanation, but it was sound in economic and parliamentary strategy and furthermore, to the best knowledge of the author of this memorandum, it went as far as the Board was willing to go on the occasion.

Would the Board have cared to comment on the principal questions from the press: Does this mean the Board is worried about the economy-- that it thinks the economy is going down? Does this mean the Board is moving to a policy of active ease?

The "spokesman" who presented the action to the press didn't think-- and doesn't think -- the Board wanted to comment on these questions except by way of maintaining firmly that the Board's reasons had been stated in the sentences quoted.

Of course the "spokesman" knew all along that the press would call it an "easing" action -- no matter what was said officially -- and that the result would be a favorable reception in most quarters, because it's always more popular to "ease." But the strategy was to leave that responsibility to the press and refuse to have it placed on the Board.

On the parliamentary front, there was a different problem. Adversaries there could be counted on to renew their argument that reserves should be supplied almost always by purchasing Government securities so that

the "benefits" would "go to the Government instead of the banks."

Due notice was taken of that angle too in the press release, just about as pointedly and strongly as the nature of a press release permits. Note that all of the actions were attributed to the inferable duty to "implement" a law that logically must represent the will of Congress since Congress had adopted the law comparatively recently. And one action was related to the indisputable obligation to comply with law.

Of course neither the press release nor the "spokesman" volunteered anything at all on the question posed in parliamentary circles. Neither would, in fact, be an appropriate instrument for that: the right instrument for this purpose is the "Position Paper." Naturally, the "spokesman" does and must stand ready to cope with problems of this kind if in his spot judgment they seem immediately serious. Ordinarily, however, the proper course for him is to use every art first to prevent (i. e., deflect or divert) such a "digression" from interfering with the "message" he is trying to get conveyed affirmatively.

Board press releases have, of course, carried far more explanatory matter than did the one employed here to illustrate the press release operation (and the "spokesman" operation as well).

For example, here are some extracts from one (also on reserve requirements) issued on June 21, 1954, when most of the present Governors were serving on the Board:

"The Board of Governors has reduced the reserves

required to be maintained by member banks of the Federal Reserve System. The reduction will become effective on a gradual basis over the next six weeks.

"The action will release from reserves more than \$1.5 billion, which will then be available to the 6,700 member banks for expanding loans and investments as the economy enters a season of rising credit needs.

"Each member bank is required to maintain in the Reserve Bank of its district an amount of reserve funds equal to a specified percentage of the demand deposits (checking accounts) and time deposits (savings accounts) outstanding on the member bank's books.

"When the reductions have been completed on August 1, the percentages applicable will have been lowered as follows:

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"The reductions will become effective according to the following schedule:

"This action was taken in conformity with the Federal Reserve System's policy of making available the reserve funds required for the essential needs of the economy and of facilitating economic growth. The reduction will release a total of approximately \$1,555,000,000 of reserves. It was made in anticipation of estimated demands on bank reserves during the summer

and fall, taking account of probable private financing requirements, including the marketing of crops and replenishment of retail stocks in advance of the Fall and Christmas sale seasons, as well as the Treasury's financing needs.

"The Board is authorized by law to fix reserve requirements within the following limits: - - - -

"The last previous reduction in reserve requirements was announced on June 24, 1953. Changes in reserve requirements supply or withdraw relatively large amounts of bank reserves, even when effected on a gradual basis, as in the present action. Accordingly, such changes are comparatively infrequent. For more flexible and frequent adjustments to the credit needs of the economy the System relies chiefly upon open market operations to release or absorb reserve funds."

Some incidental items about that one:

1. It is an authentic press release in that it could be set in newstype "as is." Reason: it incorporates all information essential to the average reader who knows nothing about reserve requirements, or the Federal Reserve either. (Chances are you were bored stiff by the elementary explanation of required reserves, demand and time deposits in paragraph three, and like matters elsewhere. But that's what made this release intelligible beyond the circle of the learned and gave it intelligibility to newspaper editors and readers totally uninstructed in such matters.)

2. It illustrates an advantage of the press release, in speed and flexibility, over the explanatory booklet. The author remembers being accused in some quarters of proposing to violate theory, practice and gospel (Purposes and Functions) by associating a reserve requirement change with seasonal needs, as was done in the second and sixth paragraphs. But the alternatives were to forego explanation, or to allow more stress on "the Treasury's financing needs", or to relate the action to a weak state of the economy -- something seldom acknowledged officially unless conditions are obviously disastrous. So reference to the state of the economy was passed over except for the neutral, oblique and diplomatic reference in paragraph six, and Treasury needs were mentioned almost as in passing in the same paragraph. Today, one could regard that release as a sort of "re-write of history," and decide, according to taste, whether it was reprehensible or not. But one could also regard it as a proper or "new theory of usage." For lowering reserve requirements to meet seasonal needs was later sanctioned in the official annual report as a proper usage of the instrument. And now the unorthodox has become accepted practice. In the public announcement of the most recent vault cash action, cited earlier in this paper, the only explanation given on economic grounds was the need to meet seasonal credit requirements.

To finish reserve requirement changes, extracts will be shown from just one more press release to demonstrate the limits to which the Board actually has gone -- and could of course go again.

These quotations are from a release issued July 14, 1936, a date on which only one of the present Governors was serving on the Board. Unlike the releases previously quoted, this one dealt with an increase in reserve requirements. Figures and other descriptive details will be omitted, wherever possible -- but note especially the parts that will be underscored for emphasis:

" ... This action eliminates as a basis of possible injurious credit expansion a part of the (over \$3 billion) excess reserves (that) have resulted almost entirely from the inflow of gold from abroad and not from the System's policy of encouraging full recovery through the creation of easy money conditions. This easy money policy remains unchanged and will be continued.

"The part of the excess reserves thus eliminated is superfluous for all present or prospective needs of commerce, industry and agriculture and can be absorbed at this time without affecting money rates and without restrictive influence upon member banks, practically all of which now have far more than sufficient reserves and balances with other banks to meet the increases.

"Furthermore, by this action the remaining volume of excess reserves... is brought within the scope of control by the Federal Open Market Committee.....

"The portion of existing excess reserves, which will be absorbed by the Board's action, if permitted to become the basis of a tenfold or even larger expansion of credit, would create an injurious credit expansion. It is for this reason that the Board decided to lock up this part of the present volume of member bank reserves as a measure of prevention on one hand and of further encouragement to sound business recovery and confidence in the long-term investment market on the other hand.

"The present is an opportune time for the adoption of such a measure... It is far better to sterilize a part of these superfluous reserves while they are still unused than to permit a credit structure to be erected upon them and then to withdraw the foundation ...

"The Board is convinced that this action will not affect easy money conditions now prevailing. It does not constitute a reversal of the easy money policy which has been pursued by the System... Rather it is an adjustment to a changed reserve situation.

"The prevailing level of long-term interest rates, which has been an important factor in the revival of the capital market, has been due principally to the large accumulations of idle funds in the hands of individual and institutional investors... The increase in reserve requirements... will not... diminish the volume of funds available for investment....

"The reduction of excess reserves ... brings them within the scope of control through the System's open-market portfolio... Frequent changes in reserve requirements... should be avoided because they affect all banks regardless of their reserve position. At this time an increase can be made equitably... Unless large additional increases in reserves occur through gold imports or otherwise, no occasion for further adjustments in reserve requirements is likely to arise in the near future...

"For current adjustments of the reserve position of member banks to changes in the credit situation the Reserve System should continue to rely on ... discount policy and ... open market operations. By the present action excess reserves will be reduced to within the amount that could be absorbed through open market operations... Conversely, should conditions develop requiring expansion of reserves, they could be increased through open market operations....

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"The Board of Governors believes that the action taken at this time will give assurance for the continued encouragement of full recovery..."

It would be hard to visualize a more strenuous effort at explanation than that. The effort at telling everything -- at least twice, in many instances -- must have been a strain worthy of the Bastille Day on which it was announced in the hot summer of 1936.

Yet seldom has belief been more misplaced than that publicly asserted by the Board in the last paragraph quoted. And seldom -- never, in the term of most members of the present Board -- has any Board action been more widely "misunderstood."

The moral, of course, is that there's a very definite limit to the amount of "understanding" that can be achieved by any means, no matter how intensive the effort. The prospects are, in fact, that so-called "understanding" will never seem attainable for the more unpopular actions that duty frequently requires the Board to make. Because, from time immemorial, people -- with the conviction shown by the Louisville banker who, in August, drew a disapproval from the Board on his application for approval of a merger -- have said "I can't understand it" when what they really mean is "I don't like it."

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b. Open Market Operations

On a Sunday in the spring of 1937, more than six months before the Board moved into its new building, the Open Market Committee went into session and a few hours later sent to the press, almost in verbatim form, a sizeable section of the Directive it had adopted that day.

Here's the way it looked when it reached newspaper offices:

STATEMENT OF THE OPEN MARKET COMMITTEE
OF THE FEDERAL RESERVE SYSTEM

FOR THE PRESS

For release in morning newspapers of
Monday, April 5, 1937

"With a view (1) to exerting its influence toward orderly conditions in the money market and (2) to facilitating the orderly adjustment of member banks to the increased reserve requirements effective May 1, 1937, the Open Market Committee of the Federal Reserve System is prepared to make open market purchases of United States Government securities for the account of the Federal Reserve banks in such amounts and at such times as may be desirable. This purpose is in conformity with the policy announced by the Board of Governors of the Federal Reserve System in its statement on January 30, 1937, which declared, with reference to the increase in reserve requirements, that by this action the System would be placed in a position where such

*Had the
Depression started?*

reduction or expansion of member bank reserves as may be deemed in the public interest may be effected through open market operations."

On the Committee were men smart and shrewd, and there is nothing in the episode to suggest they had succumbed to "goldfish bowl" folly or a simple-minded impulse to indiscreet self-exposure.

What they were demonstrating was a fundamental principle of intelligent communication: When you have something to say and a good reason for saying it, then say it -- and by the most effective means possible.

"Misunderstanding" (i. e., opposition) was running high at the time, for reasons suggested earlier in the account of the 1936 reserve requirements reduction. The Committee looked squarely at its problems and resolved to do something about them.

What do you do when you see the public -- agitated by some holders of public office -- showing signs of unreasonable fears that a "tight money" obsession on your part will wreak economic havoc? What if similar apprehension is visible in the condition of the bond market?

And what if, at the same time, you see bankers showing anger over another reserve requirements hike announced to take effect later -- and also showing alarm that they've become the target of "bureaucratic persecution"?

The answer, correctly adduced by the Committee, is that you start making every effort you can to spread some reassurance around -- on the double-quick -- for everybody who needs it. So reassurance was provided

as swiftly and broadly as possible -

- to the public (and concerned politicians) that the Committee planned to make ample provision for credit needs;

- to the financial markets (and some of the same politicians) that the Committee planned to insure an orderly market;

- and to the banking community that the Committee was mindful and sympathetic about the problems facing the banks and that it planned to "facilitate orderly adjustment" by the banks to the forthcoming hike in reserve requirements.

From the standpoint of the art of communications, however, the master stroke was in the strategy adopted to make the message of reassurance as convincing as it could be made -- and to induce the press to spread it to the whole country.

For one thing, the Committee recognized that, in a situation like this, it's best to speak through actions. Of course only the simplest actions -- such as drawing back a clenched fist -- are self-explanatory. But actions are more convincing than words in demonstrating sincerity. They show that you're not merely promising that you will do something but that you already have committed yourself to do it.

Public revelation that a directive had actually been adopted would give one evidence of sincerity, but could something else be done to strengthen the evidence?

Years later, when President Eisenhower suffered a heart attack and rumors spread over the country that he was paralyzed and helpless, there was to be a fine demonstration of the technique for quieting a fear that can lead to panic.

White House operatives wouldn't just say that the President was not helpless -- they would try to show it by a recital of details that included the fact that he had "shaved himself this morning"; and then they would drive home the impression of infinite frankness by putting among the details the attending doctors' notations regarding the Presidential bowel movements.

Of course the Committee didn't have that model, but it used the best means it had for conveying sincerity through frankness -- release of text from a document normally held "secret" for many months.

The Committee did not in truth reveal everything about its meeting by any means. Presumably it also recognized that indiscriminate revelation can equal indiscretion, cause distraction from The Message, and be pointless anyway.

Neither the public nor the press, therefore, was burdened by knowledge that the Committee had split, 8 to 3, on whether the trading desk should be ordered to hold to a "minimum" during the next week actual purchases of securities the Committee had publicly declared itself "prepared to make." The majority voted to make it the minimum.

In narrating this precedent for giving out at least part of the text of an Open Market Committee directive with no delay whatsoever, the writer

of this memorandum is not suggesting it as a practice. It was a fine performance because the need it met was extraordinary. For meeting more ordinary needs, it would be a foolish practice.

Ordinarily, in the opinion of the writer, there is no need for any more "disclosure" of intimate material of the Open Market Committee than the present practice provides. O.K.

As to faster disclosure, it is hard for the author to understand how that would benefit the Federal Reserve, although he can see how (and why) it would delight the press and also some members of Congress to get policy record entries no later than three months after the entry dates -- and earlier than that, if possible.

From a Federal Reserve point of view, the chief use that members of the press and of Congress make of the policy record entries when the annual report finally gets out is entirely negative.

The entries often get used, in fact, as "admissions against interest" are used in courtroom trial. Dissents in the voting record can be (and sometimes are) presented as showing "confusion" and "dissension" inside the Federal Reserve over policy. (Typical version: "Even some of the members of the Committee admit the policy is wrong.")

Of course there is nothing that can be done about that sort of thing, except to meet it by the only method available -- counter-presentation.

("Spokesman" version: "The only thing that the dissents show is that all points of view, including those of the most outspoken critics, are presented

ably before the Committee, and the only thing significant is that -- so far -- the Committee as a whole has not considered the arguments 'against' to be persuasive.")

Text of the Directive

If the directive were an instrument for internal communications only, this paper would have no concern for it.

But since it reaches public gaze once a year, and there's always the possibility that more frequent revelation might be forced, it would here seem advisable to effect some change in the directive's form.

General rather than specific, abstract rather than concrete, the present form would be unsuitable for the use to which a portion of text was put in 1937 if ever the need of that time should recur.

Worse, it presently leads at times to embarrassment for the System when portrayed in print as symbolic of "central bank mystique," intended more to confuse than inform.

The Board is surely aware that, even within the Federal Reserve, association of the directive with utterances of the Delphic oracles is commonplace.

That association is not confined to jests about a common capacity to confuse. Unhappily, it extends also to suspicion that there is a common strategy -- i. e., to speak in a manner admitting of diverse or even contrary interpretation, so that the "infallibility of the oracles may be maintained whatever the event."

Some writers go so far as to regard the directive as confirmation that the Federal Reserve is either "unable or unwilling" to say what it is doing.

It may be possible to determine something about the feelings of persons outside the System by running through a directive as a fairly typical outsider himself might do.

The directive current at the time of this writing will be taken here as a representative example of most directives adopted by the Open Market Committee in recent years.

It contains about 270 words, in two paragraphs. The indicated purpose, the reader sees, is to give the Federal Reserve Bank of New York instructions on security transactions pending the Committee's next meeting.

A straightaway run through the whole document leaves the reader feeling somewhat dizzy from roller-coaster clauses and sentences.

As he recovers, he recalls the second paragraph looked the least complicated. So he starts reading it again, to see if anything interesting is revealed.

In paragraph two, he finds, the Bank is told to buy specified securities direct from the Treasury "as may be necessary ...for the temporary accommodation of the Treasury." Nothing is said, however, as to how much that might be or how determined, except that the Bank is told it mustn't run Federal Reserve holdings of these securities above a half billion dollars at any time.

The reader feels stumped thus far, so he turns hopefully to paragraph

one. There, he sees, the Bank is being told what to do about buying, selling or exchanging securities -- especially in dealings where the Treasury is not directly involved.

The Committee, he gathers, wants the Bank to engage in some transactions of this kind, but doesn't want the transactions to change the Federal Reserve's total holdings -- either up or down -- by more than a billion.

By now, the reader is into the middle part of paragraph one and on the alert for anything he can pick up.

The Bank, he sees, is to buy, sell or exchange (no clue there) "as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country." (No clue there either, so far as the reader can see.)

Next, the reader finds that whatever the Bank is supposed to do in the light of economic and credit conditions (whatever that may be, he muses) is supposed to be done "with a view to" three other things.

These three are set out in clauses designated alphabetically, so he closes in on them for real last-chance effort, taking them in order.

In (a), he sees, the Bank, in doing whatever it is that it was supposed to do, is supposed to do it "with a view...to relating the supply of funds in the market to the needs of commerce and business." Sensible, he decides, but not informative.

Moving to (b), he finds the Bank is further supposed to behave however it behaves "with a view to...encouraging monetary expansion for the purpose

of fostering sustainable growth in economic activity and employment. "

Worthy aim, he agrees, but awfully vague for an "instruction." Baffled, he turns at last to (c), hoping weakly against fading hope.

There he finds that the Bank, in its doings, is also to proceed "with a view...to the practical administration of the Account." Nothing in that for him except wonderment that a Bank would need to be told to consider that.....

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Good objectives are commendable, and properly stated as the ultimate end toward which the Committee's work is directed.

But for reaching so far, the manager of the Account has a rather short stick.

If the Committee could instruct the manager of the Account in respect to more attainable results -- desired levels of free or total reserves, for instance -- the purposeful competence of the Committee and the System would be better reflected.

O. M. Operations: The Running Account

In the weekly condition statement, in contrast to the directive, the facts on Open Market operations are presented clearly.

A veritable marvel of compilation, the condition statement does not stop with providing every Thursday the net figures on all operations of the Open Market Committee, complete through the preceding day. It also provides

the figures on just about every related item that persons interested in monetary matters might want.

Still another service is furnished by the statement.

In three lead-in paragraphs of sturdy data-in-prose, it plucks figures from the neat columns below and assembles them in meaningful form.

Quite an assist for the reader too unversed to do that for himself. Without further work on his part, he can quickly find what happened during the week to the reserves of member banks, and how it came to happen.

To cap the performance, the statement produces--in a single terse sentence near the middle--the figures on which interest mostly centers today. Those figures, showing the level and movement of free (or borrowed) reserves during the week, is widely considered the score for that week's game.

The only trouble is that this isn't enough for the really hot fans. How can they tell, even from all this, whether the score resulted from hits or errors?

The answer is that they can't, so they must go beyond the statement. And the place they have learned to go, at least those who are members of the press, is the Federal Reserve Bank of New York.

There, every Thursday afternoon, the figures of interest -- those that appear on the front page of the condition statement -- are given to the press somewhat earlier than they become available in Washington.

The New York Bank doesn't have time to get out a written text grouping the figures, as is done in Washington. But whatever service is desired in that respect is provided orally.

At this point, a "spokesman" (the job is rotated among several officers of the Bank) takes on questions. The questions and answers center on the hits or errors question.

Does the free (or borrowed) reserves figure show the Committee and its trading desk hit the target? (By inference, what is the real target?)

Any freak effect here--did float or money in circulation or gold or something else go wide of expectations? (Still, by inference, what is the real target? What is the real trend of policy?)

It is, of course, bad form for any "spokesman" -- in New York or Washington -- to walk or slip into traps, for between his principals and the press there is a conflict of aims of which he must be mindful.

The service he must try to perform for his principals is to keep the "facts" -- e. g., an erratic movement of the figures, when there is one -- from speaking misleadingly about his principals' actions and aims.

The disservice he must try to avoid is the indiscreet revelation of aims and objectives that he knows his principals do not want revealed.

The line he walks can be very fine, and it does not lead to popularity with the press. Yet, if he walks it well, the press may give him the one award possible: respect for him and his principals.

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When retirement came in 1959's early spring to Harold V. Roelse, a veteran among the New York Bank's "spokesmen," members of the press went to the unprecedented length of giving him a testimonial dinner. In

accounts of his death an unhappily short time thereafter, there was no mention of shock.

In Washington, each Thursday, the front page of the condition statement is moved in its entirety by the Associated Press onto one of the wires that carry the A. P.'s comprehensive news report. Thence it is relayed across the country.

That comes very, very close to taking care of the wants of every newspaper anywhere with a regular interest. Not many have that interest: figures that change so modestly in most weeks have as a rule little value for news and none for sensation.

Now and then news value picks up. In times of TIGHT MONEY TENSION, several of the figures are NEWS. When an outflow of gold signals DOLLAR CRISIS, the gold movement digits can be DRAMA.

But most Thursdays the A.P. man who must dictate the statement's whole front page over a phone complains about routine that takes time from NEWS. Nor is his mood lightened by the competition's song, "Front-page to Back-page again."

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c. Changes in Discount Rates

The "Discretionary" Adjustment

Asked to suggest the single deed that would do more than anything else to foster "understanding" of the Federal Reserve, the author would say: end discretionary changes in the discount rate.

Told to forget it and to try again, he'd say: "Do the best you possibly can to explain discount rate adjustments -- and put something in writing."

In the writer's judgment, no Federal Reserve program to better understanding can advance far under the discount rate burden.

It may be possible to induce extra millions to accept the logic of high and rising interest rates as a counter to inflation.

It may even be possible to slow the pace at which economists and public officeholders are proposing alternatives to and substitutes for the "high interest method" of combatting inflation.

But nobody is ever going to make high interest rates -- or those suspect of fixing them -- beloved by the mass of the people.

In the author's opinion, people -- even the masses -- can be persuaded to accept monetary restraints, and any level of interest rates that may go with them.

But they will not be unless this case, at a minimum, is reasonably made:

1. That the monetary restraints applied are means to an end the people want attained.

2. That the restraints are reasonably effective -- so far as circumstances permit -- in attaining that end.

3. That the restraints are not directed toward some other end, and that the interest rate effects produced are incidental.

Time and again, with ant-like persistence, Federal Reserve representatives have striven to gain public understanding and acceptance of that thesis.

And time and again those efforts have been discredited and defeated by discount rate actions, which almost invariably and universally are regarded as proving the thesis is false.

No space need be devoted here to the point that the discount rate adjustment is almost peculiar among monetary instruments in its power to provoke political problems and threats to the System's independence.

In the author's opinion, that point was established fully by the events of 1956. A resume of those events was furnished members of the Board August 25, in a paper titled: "The Federal Reserve and the Political Gantlet: 1956."

Also, no space will be given to expansion upon the "leak" and "conflict of interest" dangers inherent in the present discount rate procedure. The potential for scandal has been evident for years.

Discount Rate Actions

For discount rate actions, though for these actions only, the present Board has gone beyond its precursors in "explanatory" effort, but not in its written announcements.

The release that announced the latest discount rate change on August 11 fully matched in terseness any of its predecessors since the System's beginning.

In five lines, 51 words, two figures and one date, it gave just three basic facts: what, where, and when the change would be. And that, as always, was all.

In the next morning's newspapers, the story took more than a column, over 1,000 words, for reporters who try to be thorough.

In early September, from three Congressional offices, came calls to the Board requesting material on the discount rate change that had been made nearly a month before.

Some oral explanation was offered and amiably received, but the Congressmen's offices still wanted a copy of "the official announcement and explanation."

In the end, the callers got two things:

One was a reproduction of the clipping of one of the newspaper stories mentioned. It was the story adjudged best, in general, from a Federal Reserve standpoint.

The other was a friendly (and truthful) tip that the newspaper

story would give the caller what he wanted -- a thorough explanation in good, plain language -- better than the official announcement could.

The incident illustrates why this paper suggests that some written explanation is in order.

It may be a fair guess that the deficiencies of the announcements would have become glaring long ago except for two circumstances:

1. Most people, Congressmen included, are accustomed to getting their information from the press, and are satisfied to stop there, unless press coverage seems on the surface too scant.

2. The Board, through the "spokesman" medium, has added some information and guidance to the press (and almost only the press) ever since discount rate activity resumed in 1953, nearly two years after the "Accord."

In this, however, as the press gradually but increasingly has become aware, there has been more guidance than information.

A "spokesman" finds it mountingly difficult to obtain what he wants-- to get the action "jumped off" in the "right" tone and direction -- with only trifling trinkets to trade.

(New "spokesmen", however, may do better. On tone and direction, the August 11 discount action fared well, in the opinion of the writer, who was NOT the "spokesman" involved.)

If there be press complaint to the Board about discount announcement procedures, it is legitimate, and overdue in being registered.

Under present procedure, the press -- to put it bluntly -- has been taken, and taken over and over again on the 21 occasions discount rates have been changed in the last eight years.

The bits it has been given in supplement of bare-facts announcements have been designed to produce stories reflecting -- in so far as that design could be effected -- the viewpoint of the Board toward the action.

That, of course, would still be fair enough, except for one vitally important point: the bits have been imparted mostly under an embargo against attribution of the material to the Board or its representative (i. e. , "This is for background-use only").

And what has happened, when the press has protested against being embargoed and being saddled with the responsibility for making on its own many "Board viewpoint" statements that the press feels should be attributed to the Board?

Why the press has been given, with occasional graciousness, the privilege of directly quoting a still anonymous "representative of the Board" on the one or two phrases he wants most to put over.

Understandably enough, this situation has become increasingly unstable. More and more, the press is breaking the embargo and -- in its own form of unfairness -- attributing to Board sources things that a reporter may believe but could never make the "spokesman" willing to concede.

Change seems in order, commencing immediately.

Making the change, if the Board wishes to say more than is said in the time-weathered form for announcement of discount rate actions, would present no problem at all.

An immediate announcement, as this paper indicated at its opening and later amplified in descriptions of the "spokesman" function, can be sufficient though short and, if need appears, followed up in greater perspective.

For demonstration, here, from an excellent source, are two paragraphs that make almost the identical points that were made orally by the Washington "spokesman" in connection with the discount rate action last June 2, the first rate reduction in 26 months:

"The economy is operating at high levels on the basis of historical comparisons. At the same time, there appear to be few, if any, bottlenecks of importance, and productive capacity generally is sufficient to support an increase in output. Increases in employment are particularly desirable. Inflationary psychology has abated since the turn of the year. The public and business have reacted calmly to the Summit crisis. Prices have been relatively stable.

"The System has taken earlier actions in the open market to ease credit. The reduction in the rate at this time

can contribute to real growth in the economy with minimum risk of renewed inflation. "

The excellent source is the President of the Federal Reserve Bank of Philadelphia. The words are what he wrote down, to prepare himself against possible inquiries, while awaiting the hour when the announcement would be released.

Next is an explanatory note the Deutsche Bundesbank provided June 2 -- the same day as the Federal Reserve announcement above -- at the bottom of an announcement that it had, among other things, raised its discount rate:

"These new credit policy measures, which are connected with the raising of minimum reserves that became effective on 1 June 1960, have been adopted in order to counteract the continuing considerable credit expansion, and thereby to check the monetary strains resulting from the disparity between overall demand and the possibilities of production. The simultaneous renewal of the orders forbidding the payment of interest on foreigners' balances and the sale of money-market paper to foreigners is designed as far as possible to prevent any interference with this policy through the afflux of foreign money.

"The Bundesbank expects that the raising of its discount rate will be reflected not only in the debit but also in the creditor interest rates of credit institutions...."

After a short interval, Germany's central bank followed through in the next (June) issue of its monthly magazine with an eight and a half page expansion, complete with illustrative charts.

A reprint of the article is available, if desired. It's enough here to note the forthright sentence that opened the article:

"On the ground of the increase of cyclical strains and the hitherto inadequate limiting of credit expansion the Central Bank Council of the Deutsche Bundesbank on 2 June this year further stiffened the restrictive credit policy...."

It takes no great search to find cases where central banks of other countries have gone still further, at the time of initial announcement, in the explanation of their actions.

One illustrative item, also available if desired, is a statement by the Governor of the South African Reserve Bank in January 1959, that runs to more than three pages of legal-size paper.

Like its counterpart in Germany, the South African bank speaks with an unvarnished candor that would startle an unaccustomed populace in the United States. Excerpts from the second and the entire third paragraph of its statement follow:

"In arriving at this decision (a bank rate cut announced in the opening paragraph), the Reserve Bank has been influenced by several circumstances. In the first place, the

available data indicate not only the existence of an appreciable slackness in several of our primary and secondary industries but also the continued slowing down in the tempo of general economic activity in the Union. This is indeed attributable mainly to the impact of external factors ... Account must, however, also be taken of the restrictive effect on the internal economy of the more stringent monetary policy which had necessarily to be applied in order to improve the Union's balance of payments position and to replenish its monetary reserves to a more satisfactory level.

"While it is admitted that certain readjustments in the internal economy have been necessitated by the substantial decline in export incomes, there is nevertheless a danger that the process might be carried too far....."

The Bank of England, the institution which perhaps gave rise to the idea that central banks never say much, recently made a debut in the cinema in a film the Bank produced itself.

The cameras are said to penetrate "even the Thursday meeting of the Court" and to show in action, and also full color, the Bank's Governor (making a proposal) and the members of the Court (expressing approval by a show of hands).

Recently also, keen observers of news stories from Threadneedle Street have detected signs of "a spokesman" in the woodpile, but he may have arrived on the job a bit late. For, on the really crucial questions, the Bank of England now gets outside help. A note, helpfully supplied to the author by the Division of International Finance, describes the arrangement.

"The Bank of England", the Division's note says, "has always avoided public explanation of any action it has taken. Increasingly in recent years, however, major monetary actions have been announced by the Chancellor of the Exchequer in Parliament.

"In such cases, the Chancellor gives a full explanation of the action, answers questions from opposition speakers and may even be called upon to defend the action in a full-dress party debate."

d. Margin Requirement Changes

If the Board provides no more explanation for actions on margin requirements than for actions on discount rates -- and it doesn't -- why is "public understanding" of margin actions so much better, especially when an action "tightens"?

The answers are three, and they may be illuminating:

1. The application of the margin instrument is easier to grasp because it is specific, narrow and direct.
2. Approval -- a powerful promoter of understanding -- is automatically greater, because the effects of the action upon the populace and the economy as a whole are widely believed to be beneficial rather than the reverse.
3. By way of legal aid to explanation, the law itself supplies a statement of purpose that seems to "explain" all actions changing margin requirements -- up or down -- although it does not really show the reasoning behind any.

The Board's announcement procedures in all other respects are just about the same for margin change announcements as for discount rate changes.

A "spokesman" sees that interested financial writers (the rest of press will take its cue from them) get an even break on receiving a release containing 50 words and four facts, one of them negative ("No other change was made in the regulations").

The "spokesman" adds some information on recent developments in the stock market credit from which reporters can draw inferences about the reasoning of the Board, but he insists that "you must make clear that any conclusions drawn are yours, and not the Board's."

(Readers of the preceding section on discount rates may recognize this as the embargo. This is the moment when the press will complain that it is being stuck with responsibility for whatever explanation it may supply in support of action by the Board.)

The "spokesman" next denies, as he must for each margin requirement change, that the Board was more concerned about prices than it was about credit in the market. (If he manages well and his luck is good, the price-motivation angle may be downplayed in the stories.)

Beyond that, there isn't much to do. If they want it, veteran reporters are given assistance on technical questions, and strangers to finance a carbon copy of a short, "unofficial" primer that says:

"Margin requirements, in non-technical language, set the proportion of the purchase price of a stock that the buyer must put up in cash. For example, when the margin requirement is 70 per cent, the buyer of a \$100 stock must put up \$70 (or more) in cash.

"Margin requirements were established initially in October, 1934, under authority Congress granted the Federal Reserve Board in the Securities Exchange Act of 1934 'for the

purpose of preventing the excessive use of credit for the purchase or carrying of securities' ".

"The initial margin requirements, in effect from October 1, 1934 through January 31, 1936, ranged from 25 to 45 per cent. Since then, margin requirements have been in effect as follows: (a table supplies the rest).

A day or so later, the Board's incoming mail will reflect a difficulty of understanding on the part of some people who feel pinched by the action, but they are few in a population of 180 million.

But others mailing comments to the Board will give no sign they had the slightest trouble in understanding any part of it. Some of this group will applaud the Board as they would a dragon slayer.

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II The Follow-up Explanation

On what was set forth at the start of this paper as the second ingredient for any program for promoting understanding of the Board's policies and actions, no lengthy treatment seems necessary.

A follow-up explanation would simply have as its general purpose the objective originally assigned it: to amplify the explanation given for an action in the release announcing it.

Perspective, it is assumed, would be provided in the course of amplification.

The follow-up could be provided in a speech or a statement to a Congressional committee (a follow-up actually has been brought off at a Committee hearing) if time and opportunity were ripe.

No iron-clad rule can be laid down about the means of follow-up, but the general rule this paper has stated would apply: the means would have to be those deemed to be most effective for the purpose to be served and for conveyance of the message intended.

If the follow-up system were to be tried on a regular basis -- in the wake of each action announcement, say, or in a monthly tie-in of Federal Reserve operations to economic developments -- the Bulletin, in the author's opinion, would be the best instrument.

Because it comes out monthly, the Bulletin can roll off something of the sort indicated without undue attention being drawn: if splash be sought, a special statement or speech would be better, but the assumption here is that a quiet tone becomes the Federal Reserve, as a rule.

It is no disadvantage, on the other hand, that the Bulletin comes out only once a month. Any time the Board wants to make public any part of the Bulletin in advance of the entire magazine, a pre-print will do the trick. And any time something that has already appeared in a Bulletin is deemed worthy of preservation as a separate item, it can be so preserved in a re-print. Pre-prints and re-prints are equally handy and attractive to the eye.

of course!!

Is this a rule?

It was noted earlier in this paper that the Deutsche Bundesbank, on the occasion of its June "stiffening of the restrictive credit policy", gave a demonstration of a central bank providing explanatory matter in an action announcement and following it up in its monthly magazine.

The re-prints of the German Bank's magazine piece, which are available to any interested Board members, are in English.

It's the guess of the author that putting a review of economic and financial developments in the Bulletin every month -- and using pre-prints to beat the time lag at the printer's -- would be the most effective means of explaining regularly anything the Board does in fact want to explain in furtherance of public understanding of policies and actions.

Why most effective?

The author's reasons are four:

1. Because System actions and policies, if explained in clear and meaningful reviews of economic and financial developments as they unfold, would be set against the background of living events.
2. Because if the explanations were thus set and so given the quality of significance to the life of the times, the press and other media of communication would relay them to readers a thousand times as numerous as Bulletin subscribers.
3. Because relayed in newspapers and newsmagazines

Four

that at least purport to carry the stuff of life and of history on the move, the material would be far more likely to catch the attention -- fleeting though it be -- of people who lack the time or interest to read anything else.

4. And, finally, because this could happen over and over -- thanks to the regularity of the Bulletin's publication -- it could gain for the Federal Reserve an opportunity for a continuing presentation of its story, in context -- a result perhaps unobtainable otherwise.

The minimum requirements to bring off the undertaking would be effective presentation -- which means, most of all, direction to a purpose and a point -- and willingness by the Board to take chances on errors along with hits.

Neither requirement can be met casually, and both may be hard to sustain. The pointed presentation will stick in the mind more than any other, and the failures of policy in action -- even more surely than successes -- will be made wider known and better remembered.

These possibilities are merely set out here for balance against the Board's apparent feeling:

1. That, presently, a case against the Federal Reserve, its policies and actions, gets made and goes largely uncontested.
2. That there is need for more effective presentation of the case for the Federal Reserve, its policies and actions.

3. That such presentation, if made, will gain more supporters for the Federal Reserve and equip and aid them to attract still other supporters.

4. That it can further produce a better public impression ("image") of the Federal Reserve and also better reception, acceptance and support for its policies and actions.

In that feeling there are many things that are true, but some that may only be hopeful.

The best-drawn presentations, like the best of intentions, can often go astray, and for the same reason: human nature, defiant of analysis, can react in ruin of the one and abortion of the other.

Yet there is ground to be won, if the try be made, that extends beyond the promotion of understanding to the prevention of misunderstanding.

For instance, every time callers brim with gloom about the economy and its prospects -- and some callers mirror the widespread opinion of well-positioned analysts -- the author of this memorandum asks:

"Tell me, do you think credit conditions are a cause of any of these troubles?"

The answer, encountered repeatedly over a fairly considerable period, has always been "No."

What the author has in mind, therefore, is something on this order:

A Bulletin article that would seek to bring out the evidence for that "No", as best it can be gotten together, and to show as objectively as possible that, although the economy and its parts may be suffering somewhat with cramps, they aren't being caused by credit conditions.

Then, if the economy does decline and fall, the Federal Reserve will at least have presented in advance a thesis that may help disqualify it for scapegoat before its critics can pin it into that role, as they have tried to do before and assuredly will try to do again.

In a pin-the-scapegoat exercise, it is foolish to present an unshielded target to opponents. The Federal Reserve, however, has done it in the past. One can still see scars -- some of harpoon size -- left over from 1929.

Yet even if the anti-scapegoat consideration were dismissed and the undertaking stripped of its more subtle potentials, a Bulletin article of the sort indicated would be in order in any eventuality, including an economic rise.

At a minimum, it would spread understanding that -- in the judgment of the Board, at least -- credit conditions are good. For some people, that could be the only reasonable assessment of national credit conditions that they have ever seen.

The author suggests, however, that the anti-scapegoat possibilities be not lightly dismissed, for there is much work -- always -- to be done to strengthen the System's armor.

As another spot for such labors on the current scene, the author submits that the gold outflow would merit a first-rate Bulletin effort directed toward bringing out, through review of developments, the various causes involved.

Who knows but what a timely and effective treatment of the situation might just possibly serve to keep the Board's own actions from being pinned eventually as the cause of it all?

In any event, the Board would not be setting any precedent if it directed the running of monthly economic and financial reviews in the Bulletin. Long articles of the kind were standard in the Bulletin for many, many years.

However, it would seem to the author futile to revive the practice without gearing the product to a practical purpose -- assuming the product is backed by the facts, of course, for no presentation can else be essayed.

What stymies the Bulletin today is not really the complexity of language that often is mentioned, nor lack of professional ability on the part of its contributors, nor -- most emphatically -- an absence of figures or facts.

It is instead, in the judgment of the author, the absence of a sense of purpose. The Board has dressed up the Bulletin in an attractive cover and style of type, but it has not as yet given it any particular place to go.

There are those who prefer the Bulletin as it is, and there are things to be said for as well as against continuance of the magazine's present form. It is, in any view, a useful publication and it is used by its subscribers for many different purposes.

Indeed, there are those who hold for it an affection of sorts, finding it mindful of the holiday season fruitcake: not too easy to digest, although well baked, but it can yield fine bits of fruit for those who know how to pick them.

III Strategic Matters: Men, Ideas and Materials

All critics of the Federal Reserve who are worth notice here may be divided into four classes.

1. Those who share your concepts and aims. They, too, value economic freedom. They, too, want a stable dollar along with high level business and employment and all the economic growth that can be sustained. They tend to criticize a single action or series of actions for being too much or too little, too early or too late, and sometimes they suggest action you are not ready to take. But because their concepts and aims are the same as yours, their occasional differences with you relate mainly to judgment and matters of degree, and they are reasonable enough to recognize it. The members of this group are as diverse as life itself: among them are doctors, lawyers, business and college economists, holders of public office, rich men, poor men, perhaps some Indian chiefs -- and who knows who else? In the main, they are men of good will, and never a menace.

2. Those to whom monetary policy is largely an intellectual exercise. To many of them, monetary policy operations resemble a financial or economic game of chess. Some are virtuosos in the recondite, and perfectionists in other people's affairs. But others are men of high character, bent upon public service: they believe honestly, and endeavor to demonstrate by the massive array of present logic and past data, that pre-set formulas will produce better monetary results than administrative judgments. Most members of this class are college professors seldom

encountered outside the pages of text-books or professional journals. Occasionally, a Congressional committee will give one of them a forum and, if he is of the lesser sort, he will seize the rare opportunity to tell exactly how monetary policy (and perhaps world affairs) should be run. Mostly, the men in this class are harmless.

3. Then there are men of substance who nurture a feeling, though it may only be subconscious, that they are possessed of superior wisdom, and therefore can perform your duties better than you. What they really want, but do not always tell even themselves, is to ordain the affairs of the world, for they are sure they can arrange things (interest levels included) better than the free market system, for is not the mind of a superior man mistress of the world? They believe themselves to be essentially on your side, and think they are showing it when they applaud an action you take that happens to coincide with one of their notions. But in the next breath they criticize your failure to put into effect another of their notions. In contrast to members of the preceding class, they have no difficulty in getting their remarks into newspapers and magazines, most prominently in publications they control. Because of their position and power, they are heard, and given some attention -- even, at times, in very important quarters. These men bear watching.

4. Finally, there are critics who are fundamentally opposed to your basic objectives -- particularly stability of the dollar -- because they are guided by concepts and beliefs that conflict with yours. There is no possibility

that anything you do can meet with their approval, except by momentary coincidence, as when you ease credit during economic decline. However, they are not all inflationists and certainly not villains, for many are true men of good will and great heart who oppose you only because they feel your policies -- however well intentioned -- impede progress to a better life for all mankind.

Mostly, critics in this fourth class fall into two groups.

The first group is made up by professional economists in university or consultant positions who count because they provide the rationale for opposition, and because they are almost awesomely articulate. One has achieved the feat of fashioning a best seller from material drawn from the dismal science. Another, of different stripe, ranges far on the speaking circuit, getting businessmen's ears at civic club meetings and, by report, converting a number to his gospel of "All This, and Heaven Too." A confident man, he sometimes engineers his host clubs into requesting that the Federal Reserve provide a debating opponent for him to work over.

The second group in this class is made up, chiefly, by holders of public office, backed in some instances by aggressive leaders of powerful special-interest organizations. Some oppose you only on an off-and-on basis, for they are concerned more with the requirements of political than of economic or financial strategy, and take their cue accordingly. Others have more deeply rooted reasons for opposing you, whether it be that they regard inflation as a panacea or the "money-changer" class as the scourge of man.

In none of these critical groups is there any important lack of understanding of either the machinery or the aims of the Federal Reserve System.

The really dangerous adversaries of the System oppose it because they do understand it: oppose it because they know exactly what it is trying to do and how it is trying to do it, and are opposed to it for precisely that reason.

It is an ironic fact that --

Ignorance, of the structure of the System in particular, and

Fear, of meddling with a mechanism so "mysterious and complicated" in its workings and its economic effects --

are regarded by the most relentless critic of the System as the most frustrating obstacles to refashioning the System to his heart's desire.

One can have the confirmation for himself, in pages of the Congressional Record that would extend from the Potomac to the Pecos and suffice to clog, if not dam, both of those streams.

There is time and space here for no more than hastily chosen samples.

Here is "Mr. Critic" himself on 23 May 1955, Congressional Record page 5824, less than a month before obtaining a vote in the House of Representatives on a resolution in which he proposes a "study and investigation" of the Federal Open Market Committee.

He is trying to lead his colleagues in the Congress out of the darkness of erroneous belief that ownership of the Federal Reserve is more private than governmental in nature -- a mistake he fears may lead some of them to

vote "wrong". He speaks, with feeling:

"Contrary to the beliefs of many people, the 12 Federal Reserve Banks are not owned by the bankers. They are owned by the Government of the United States. The money that is issued by these 12 banks is issued upon the credit of the Nation and the stockpile of gold. All of the gold also belongs to the United States Government. The gold is useful in international transactions but serves no useful purpose in our domestic economy. The 12 Federal Reserve Banks do not use anything for money except created money or manufactured money.

"The small amount of so-called stock owned by the private banks in the Federal Reserve System is not stock at all. It is a token investment upon which the banks receive 6 per cent interest only for the psychological reason of making the banks feel they are a part of the Federal Reserve System. Insofar as ownership or part ownership is concerned, the investment is 'phoney' The so-called stock cannot be voted; cannot be sold, cannot be hypothecated. It has no relationship to ownership. . . ."

But sometimes attention is hard to hold, and understanding hard to win.

Three weeks later, on 15 June 1955, the House voted "wrong", 214 to 178, and the resolution was rejected.

Here is Mr. Critic again, 19 September 1957, Congressional Record page A7524. It is two and a quarter years after his 1955 defeat. It is also six months since he has gotten the House to vote on another of his investigation proposals, this one dealing with the whole subject of national monetary and credit policies and the financial structure of the United States. On this latter occasion, 27 March 1957, the House has again voted "wrong", 225 to 174.

Mr. Critic, a persistent if not always a patient man, is reviewing the causes of his two defeats. At the moment, he is still analyzing his loss in 1955. He is blaming arguments "varied and complex" for his defeat. Mr. Critic speaks:

" In 1955, the principal arguments made against House Resolution 210 were (a) that the proposed investigation was not needed and (b) that such an investigation would be dangerous, in that it might upset the Nation's prosperity. For example, the gentleman from Illinois (Mr. Leo E. Allen), who led the opposition's debate, likened the proposed investigation to our boyhood inclinations toward 'meddling' with watches. He said: 'When the watch was running well, we probably meddled with it, experimented and pulled it apart, and then it did not run. I think we have the same analogy here.' In a similar vein, the gentleman from Michigan, Mr. Wolcott ... too, saw, somehow, a danger that a study of money and credit matters might dampen the prosperity....."

... The bear-baiting colleagues, however, have lost interest in the sport and no longer listen. . . . The press gallery, above the speaker's head, has largely emptied too when, in welling bitterness, Mr. Critic turns his ire upon the press for "confusing the issues"

* * * * *

It is not the author's purpose to speak in praise of ignorance and fear, for they are shaky allies at best and there is always the peril that they will be turned back against you.

Yet understanding, too, has its dangers.

It isn't necessarily true that understanding in the sense of comprehension of the Federal Reserve System -- whether of its structure, functions, actions, policies, operations or purposes -- will bring understanding in the sense of empathy, and support.

Understanding lies behind the proverbial inability of valets to regard their masters as heroes. And it's almost at the forefront of Alice Roosevelt's remark about a former presidential candidate: "You have to really know him to dislike him."

In educational and explanatory material of general nature concerning its work and related matters, the Federal Reserve is richly equipped, and steadily becoming more so.

It is, in fact, doubtful that there is in all the world a single institution, organization or even an association of organizations -- public or private -- that matches the Federal Reserve in this respect.

In a "List of Free Materials Available to Professors" that is compiled annually by the Educational Service Bureau of the Wall Street Journal, 5-1/2 of the 1959-60 edition's 28 pages are devoted to Federal Reserve offerings of booklets, pamphlets and films.

The nearest rivals in a field of 65 listees, ranging from the Advertising Federation of America to Western Union Telegraph and Arthur Wiesenberger & Company, are the American Bankers Association, the American Petroleum Institute, the Chamber of Commerce, Dun & Bradstreet, and the U. S. Small Business Administration. Their offerings take up approximately one page each. The System takes almost that much space just to offer materials newly made available since the 1958-59 edition.

In addition to being numerous, the System's educational materials are good in quality and wide in the range of their potential readership, both as to subject matter and susceptibility to comprehension, as gauged by the levels of educational attainment of prospective readers.

Federal Reserve Operations in the Money and Government Securities

Market? There is available a 105-page book with that title. The book contains, among other things, "sections on the role of the national money market, Government securities market, what the Trading Desk does, the use of projections and the 'feel' of the market, and operating liaison with the Federal Open Market Committee."

It is a first-rate book for anyone interested in its very specialized subject matter, and it can be helpful to employees of the System and of the 17 or so firms in which people make a living from dealing in Government securities, as well as to anyone else who may be interested. It is "intended primarily for students of money and banking," more particularly graduate students.

For those who might regard the going a bit hard in that book but who are nevertheless interested in the same specialty, the New York Bank also makes available a "layman's account of the workings of the New York Money market," entitled The Money Side of "The Street". This one is intended for "bank-management trainees, for businessmen with an interest in the money market, and for college students."

To meet a more basic requirement, to provide information on the System's origin, development, structure, instruments, operations and so on and to relate the System to the money and banking system and the economy, the Federal Reserve has several offerings.

The two perhaps most widely known and used are the Board's The Federal Reserve System: Purposes and Functions and the New York Bank's Money: Master or Servant? They are intended for complementary reading, and are designed accordingly.

The Board's 224-booklet is described as "intended primarily for students of money and banking, but suitable for bankers and businessmen." The New York Bank's 48-page offering provides "nontechnical explanation... written for high school teachers at their request, but suitable for college

students and interested adults. "

Still, pupils lower on the educational ladder have not been overlooked. The New York Bank also has a 20-page booklet, The Story of Checks, that not only tells about the check-clearing process but also essays a capsuled account of monetary instruments and their use.

(The Story of Checks is done in color and contains the drawings that prompted the press to call it, in friendly fashion, a "comic book," and a member of the press, also in friendly fashion, to inquire of the author if he would be "putting out anything soon on cereal boxtops.")

This great body of educational material has many values for the System, and work on additions and improvements deserves continuance.

The material fulfills the obligation of the System to meet requests of various kinds for general information about the System. It will impart knowledge of and about the System to all who read it. It serves not only for reading, but also for reference.

As a prosaic but nevertheless practical service, it saves enormous amounts of time that might otherwise have to be put into correspondence furnishing general information in response to inquiries.

Possibly, it may also serve a purpose deemed very important in this paper: to leave a favorable impression of the Federal Reserve System with readers, even after all memory of monetary details has faded from their minds.

Conceivably, this literature in its entirety might even furnish all the

"how-to-do-it" information needed to set up a central bank in some far-away clime, or to reconstruct the Federal Reserve System itself in the unhappy event of a nuclear catastrophe on a national scale.

But there is one thing it can never do. And that is to respond to the question foremost in the minds of the people who count most -- especially after some action has been announced:

Why is the Federal Reserve doing what it is now doing or what has just been announced, and why isn't it doing (a) more, (b) less, or (c) something altogether different?

Of course, like the law authorizing margin requirements, Federal Reserve educational material does suggest purposes that might seem to explain any action, in either direction. But nobody among those who matter most considers it a substitute for an explanation of the reasoning behind any particular action.

For dealing with the really dangerous men, and the others who bear watching, this literature is -- if possible -- even more inadequate.

Hence, there is need for what was set out at the start of this paper as the third ingredient of any program for promoting understanding of the Board's policies and actions:

The "Position Paper" or "White Paper" treatment of matters of strategic importance: i. e. , subjects or theories in debate in parliamentary, academic and popular quarters that have a vital bearing on the task of the Federal Reserve and its ability to carry out that task.

* * * *

Now the long march has brought us at last to the point of decision, the area where outcomes will be finally determined, at some unknown point in time.

In this area, the issue is how -- and to what ends -- monetary powers should be used and, consequently, who should control their use. The battle here is for the public mind, and the victory will go to the side that captures it.

This is a battle that is not going to be won on the playing fields of the school system, for what is involved is not schoolroom but public education, mostly of adults, many of them already learned.

And compared with what is involved here, almost all that has gone before in this paper -- perhaps all of it, in fact -- is kindergarten stuff.

In fine, we are past the point where the problem was merely to show reasons why particular monetary actions were taken, and we are arrived at the point where the problem is to show why such actions should ever be taken at all.

For a better look at the problem at this point, let us cross the lines into the camp of the opposition -- which holds the initiative and has launched the assault -- and try the view from that angle.

Two things will need to be borne in mind:

1. The scope of the subject dwarfs that of this paper, and we will do well to catch even the edges of its profile.

2. The issue is NOT one of "life or death" for the System. Everybody in the opposition wants banks supervised, checks cleared, and money created, so there's no melodrama of survival here. The Federal Reserve may be altered, but it will live.

A single glance shows the opposition to be a coalition, divergent in aims and linked only by the necessity to do something about monetary policy to accomplish any of those aims. Both the weaknesses and the strengths of a loose confederation are present.

One faction is made up by the heirs of Bryan and the Populist movement, in public office and across the countryside. It has a deceptive air of always being about to wane, but its leader is aggressive and death and seniority are moving him toward a position that carries much power.

The principal aim of this faction is simple: lower interest rates, forever and always, in all times and circumstances. It is not the desire of this faction to destroy the Federal Reserve, but to convert it into an engine of inflation to keep rates down. *rather slow!*

long or short run?
The second faction is not so old-fashioned, and not so unsubtle. It believes a little inflation is necessary for full employment of men and machines, and hence for the general welfare. This faction has adherents not only in public office but also in business and labor quarters, where its deceased leader once carried much weight.

Note, though, that while this faction feels it is necessary to have some

inflation, it is equally insistent that the amount of that inflation can be -- and must be -- held small, and restrained to a creeping pace.

In the plans of this second faction, it is necessary that the Federal Reserve not only remain alive but also continue to fight valiantly against inflation -- except that, most important of all, it must never quite succeed.

A third faction -- some non-members, but not all, consider it the "left wing" of the opposition -- puts its faith in a more radical idea: that the way to overcome the inflation problem is to inflate.

This idea is expounded with astonishing earnestness, constancy and force by the faction's leader, a man who already once has enjoyed -- in every sense of the word -- official access to the ears of a holder of the highest office in the land.

On present holders of public office, business-civic club audiences and the populace at large he pours an endless stream of oral and pamphlet argument, well studded with statistics, that may perhaps be compressed to this:

1. The best way to maximize growth and to overcome inflation -- at one and the same time -- is not to restrict demand by either monetary or fiscal restraint but to pump up that demand by monetary and fiscal expansion.

2. Phenomenal benefits will flow from the chain of events thus set in motion: growth will increase at an unprecedented pace, and productive capacity will go up with it; then full-blast use of ever-expanding capacity will not only satisfy ever-expanding

economic and social wants, but also do it at lower prices -- because unit costs will be reduced.

In this scheme, the Federal Reserve would be needed badly, but its behavior and bent would be changed.

The leader's scheme enchants many, but he and his philosophy evoke suspicion among many others that, if the three shells ever stop moving, there may not be any free lunch under any of them. Occasionally, the leader encounters frustration, but that only spurs him to more earnest and intensive effort. He is blind to signs of boredom.

The fourth faction appeals to -- and is reaching -- the widest audience of any; it appears to be outdoing the rest in gaining adherents; and it may prove in the end to be the most effective of all.

It has a disadvantage that the Federal Reserve has itself: it poses a threat to the dreams of all the other factions and those who go to make them up, for the fourth faction opposes inflation as vigorously as the Federal Reserve itself.

That is its strength as well as its weakness. Thereby, it taps the same body of support the Federal Reserve does among those opposed to inflation -- and there are indeed many so-minded -- just as surely as it, too, meets resistance from the inflationists.

The fourth faction's quarrels with the Federal Reserve are few but they are deadly.

It believes the System's actions neither reach nor can reach the real

cause of inflation -- which it identifies as the monopoly power wielded by some unions and industries, working in tandem, to push wages and prices even higher.

And it believes that the System, in endeavoring to do the right thing in the wrong way, not only is doing no good but is doing positive harm, manifested in many ways:

In unnecessary (and unnecessarily prolonged) unemployment of men and machines; in unnecessary hardship for those who are economically weakest and therefore are hardest hit by either inflation or deflation; and in unnecessary obstruction of economic and social growth and progress.

What the fourth faction wants is not to destroy the System but to supplant it with some form of direct control over the wage and price spiral that it believes would be more effective and more free from harmful side-effects.

Where the other three factions would be willing to allow the Federal Reserve its same or an even bigger chair in their parlors, the fourth faction would relegate it clear to the kitchen, and perhaps below stairs.

The fourth faction, however, has one giant -size problem yet to solve: what kind of wage- and price-control scheme to offer that will produce all the envisioned benefits without producing as many harms, and perhaps the same ones, that the faction now ascribes to the activities of the Federal Reserve.

Despite that enormous defect, the fourth faction's doctrine may prove tougher to counter than the doctrines of all the rest.

The hopes it raises for more effective anti-inflation results, free from harmful side-effects, may cause it to draw away from the System many who

now support the System for its anti-inflation efforts.

Too, it appeals to many who genuinely fear, in their minds or their hearts, that the System is more concerned for the dollar than for the working man or humanity itself.

This matter of feeling is not unimportant. Most people who know of Walter Bagehot seem to remember but one thing he ever said: "Money will not manage itself." But here is something else that Walter Bagehot said:

"...So long as the human heart is strong and the human reason weak, Royalty will be strong because it appeals to diffused feeling, and Republics weak because they appeal to the understanding..."

The last part may not quite have captured what is happening on the American scene today, but there is perception in it just the same.

Where is there a Federal Reserve study -- or speech -- dealing with the causes of unemployment that might not only serve anti-scapegoat purposes but also indicate the Federal Reserve has interest in -- and perhaps compassion for -- human misery?

People to whom feeling matters, and there are many of them among the Federal Reserve's friends as well as its critics, do not find these matters neglected in the economic presentations of the fourth faction's leader.

If we are to compete with this man for the public mind, we had best not waste time finding faults with his work or personality in the privacy of our halls.

He has been competing busily for some time in the free market in ideas. The Affluent Society is no longer merely the title of his best selling book, it is

Dawley

a term -- and a concept as well -- that has passed into the language of contemporary speech.

The fourth faction's "message", furthermore, is being carried by other economists into quarters remote from the popular front.

The American Scholar, "a quarterly for the independent thinker published for general circulation by Phi Beta Kappa," transmitted the message to serious readers in its summer edition a few months ago.

The author of that piece was Abba P. Lerner, professor of economics at Michigan State University, an institution whose president is chairman of the board of a Federal Reserve Bank branch. An excerpt follows:

"...A new element has entered the picture...the growth of the power of large corporations and of powerful trade unions to increase the prices of the product or of the labor that they sell, even in times of considerable depression and incomplete utilization of capacity. Instead of inflation being caused only by pressure of buyers trying to buy more goods and services than the economy can produce, so that it is always a 'buyers' inflation', it is now possible to have inflation even when this is not the case -- even when the output of the economy is far below capacity and there is substantial unemployment. We also can have 'sellers' inflation', when prices are raised by the pressure of sellers.

"With this development, attempts to stop a sellers' inflation by restrictive fiscal or monetary measures, which would be the appropriate cure if it were a buyers' inflation, only bring about depression. Attempts to cure this depression by expansionary monetary or fiscal policies only restore the sellers' inflation. The resulting frustrations have induced a regression to a pre-Keynesian worship of a balanced budget as a charm against the be-devilment of inflation in the midst of recession. Instead of the budget being used as an instrument for balancing the other expenditures in the economy so as to maintain prosperity, prosperity is sacrificed, as in ancient (pre-Keynesian) times, to the fetish of a balanced budget, and the economy continues to suffer from sellers' inflation moderated by induced depression... "

In another quarter usually regarded as remote from both the popular and the intellectual fronts -- a publication of the American Bankers Association -- the same "message" reappears.

The transmitter in this case is John M. Clark, a former president of the American Economic Association.

The publication, copyright 1960, The American Bankers Association, is a 68-page booklet, The Wage-Price Problem, which presents results of a study commissioned by the ABA's Committee for Economic Growth without Inflation. This is Mr. Clark speaking, pages 52 and 67:

"...The tendency to undue reliance on (restrictive fiscal and credit) policies stems partly from the default of other readily available remedies, and is fortified to the extent that the belief prevails that the real cause of any inflation is always excess demand, to the exclusion of any independent role of price and wage policies. An added factor in this line of thinking is the view that it is wrong to 'accept' even the smallest degree of inflationary trend. This view is commendable if it means that we should remain dissatisfied and should continue to seek further remedies consistent with our general scale of economic values. It becomes dangerous if it is construed to mean that we must insist on a quick stamping out of all traces of inflationary trend, using for the purpose the most readily available methods: namely, fiscal and credit restrictions. The danger is that this would mean harmful restriction of production and employment, without eliminating the inflationary trend that derives from price and wage policies. The latter policy would mean that we should be so unwilling to accept anything short of perfection in the elimination of inflationary trends that we would accept instead something seriously imperfect in the matter of production and employment...

"As regards policy toward the effect of price and wage policies on inflation, the implications of the present study point to avoidance of compulsory controls of prices and wages, and avoidance of the more subtle temptation to rely on fiscal and credit restrictions to do more in the way of restricting increases in the price level than they can properly and safely be called on to do..."

Against the older contentions that speeding or creeping inflation is good, necessary or enduringly beneficial, the System is supplied with some fine ammunition from the still-useful work of Winfield Riefler and others.

How well is it equipped to deal with the newer ideologies, if they may be called that?

Can the System make a good showing that monetary restraints do get at the real causes of inflation, wage-spiral problems included?

Can it make a good showing that monetary restraint is not the cause of unnecessary unemployment (and unnecessarily prolonged unemployment) of men and machines?

Can it make a good showing that monetary restraints have no distinctively discriminatory effect on various classes (and thereby support the "spokesman's" contention these restraints bear not upon classes but marginal cases within classes)?

Can it make a good showing that monetary policy is actually helping rather than hindering economic growth and social progress?

If it can, it had better get busy at doing it, and keep busy at it, for there are many more questions to tackle.

The purpose and need is clear, and possibly clamorous. And there are instruments for effective presentation: the "Position Paper" or "White Paper".

Nothing fancy is intended by the use of either of those names. So far as this memorandum is concerned, nothing more is meant by either than a

serious, affirmative, purposeful exploration of a subject -- more comprehensive in scope than a Bulletin review or article would be normally -- that points unmistakably to, or states, a conclusion.

Once set, it can be released on its own and later incorporated in the Bulletin for further availability, if its length permits. The conclusion and the essential supporting material can be re-stated in speeches and in statements to Congressional Committees, and they can be given new life in "visual" or "illustrated shows".

Uses will not be lacking. They are not lacking now.

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IV Some Program Notes

The idea that the Federal Reserve has a "tradition" of silence is spurious.

The evidence of that is by no means confined to items already cited:

- Public release of a sizeable section of an Open Market Committee directive, almost in precise verbatim form, on the very day it was adopted.

- Public revelation of the future course of monetary policy, as well as of the future course of the economy.

There is far more than that in the records covering nearly a half century of Federal Reserve history:

A Chairman of the Board of Governors has engaged a

member of the United States Senate in debate over a national radio network.

Members of the House of Representatives and of the Senate have been lectured in open correspondence. The banking community has been given like treatment, along with other individuals and groups.

Publications have been contradicted in print. So have a President of the United States and a Secretary of the Treasury.

What has characterized Federal Reserve communications over the long pull has not been Silence, but Shouts and Murmurs -- in cycles.

Well, there is a time and a place for all things, and many of the things done in the past were made necessary by circumstances, as they could be made necessary again.

In the view of the author of this memorandum, however, the present is no more a time for Shouts than for Murmurs, or for Silence either.

The focus of this paper has been on just three basic ingredients that would seem to the author necessary in any program to promote a better understanding of the Board's policies and actions.

It would be, of course, an easy task to devise a more elaborate program, if that be the Board's desire.

Yet programs, like growth, need to be sustainable, and it might well be strain enough for the Board's or the System's entire organization to make

creditable progress in handling the problems covered herein.

And as for the formidable problem of taking positions and preparing papers to present them in the future -- well, whatever became of yesteryear's project for an index to make it possible to find with certainty and ease what positions the Board has taken in the past?

Patience is as necessary as purposefulness to efforts to promote understanding, for the goal can never fully be achieved even where the pursuit of it never ceases.

In the author's judgment, a "crisis" approach to the problem of understanding would, at this time, be very much mistaken.

If there truly is a crisis at hand today in Federal Reserve relations with the general public or with either of the two institutions that lay most claim to representing the public -- the Press or the Congress -- it has escaped at least one vigilant observer.

In the course of this paper, notation has been made of difficulties encountered at times by a Federal Reserve "spokesman", hence a word of perspective might be proper.

Many times, between the "spokesman's" principals and the press, there is a conflict of aim involving policy matters, and the only course for the "spokesman" then is to side with his principals, and give no worry to press friction.

Most of the time, however, between his principals and the press there is nothing worse than a language barrier to understanding, and the "spokesman" is

free to work on the side of the press. That is fortunate for his personal relations with the press, and perhaps for his disposition as well.

How would one measure the public's attitude toward the Federal Reserve?

The American Bankers Association some time ago commissioned a private firm to survey public attitudes toward the Federal Reserve along with attitudes toward certain other institutions. The firm's subsequent report on "in depth" interviews in several cities purported to show most persons who professed to know of the Federal Reserve also professed to be well disposed to it as an inflation fighter.

Probably a more solid clue is offered by a poll taken by the National Federation of Independent Business of its "100,000-man nationwide independent (i. e., small) business- and professional-man membership" in 1957.

The question the Federation put into its poll was so stern a test for the Federal Reserve that it drew a protest to the organization from the ever-perceptive Elliott Thurston, when he saw a copy of the questionnaire before the results were in. This was the question:

"Are you for or against the Government's 'tight money' policy which restricts bank loans and increases interest rates?"

Amazingly enough, when the results were unveiled by the Federation on 6 December 1957, the answer was as follows: "47 per cent of our members who used their ballots favor 'tight money', 41 per cent oppose it, while

12 per cent indicated no preference." (Mr. Thurston could, and did, relax.)

A year later, then-Chairman Wright Patman announced results of a canvass by the Joint Economic Committee of "professional opinion (1,500 economists in 150 universities) concerning economic stabilization and related banking policies." Some results follow:

"In its anti-inflationary actions of recent years, how would you characterize the Federal Government's use of the following basic policies? Too little? Enough? Too much?"

The number of respondents to this and most other questions was 615. Of them, with regard to monetary policy, 50.4% checked enough, 25.7% too little, 19.0% too much.

"In its anti-recessionary actions during recent years, how would you characterize the Federal Government's use of these policies?"

On monetary policy: 69.8% enough, 20.3% too little, 6.7% too much.

"In the control of inflation, a combination of policies may be called for and varying emphasis may be appropriate under difficult circumstances. If you believe, however, that as a general proposition reliance or preference should be placed more heavily on one type of policy than another, please indicate."

Of the 209 respondents who indicated at all, 56.5% indicated monetary policy, compared with 26.3% for tax policy, 11.0% for "expenditure policy," and 6.2% for direct controls.

"Do you believe:

"A. That 'tight money' served to dampen inflation during 1955-57?"

Yes 74.6%, no 21.1%, no response 4.2%.

"B. That, by adding to costs, or otherwise, 'tight money' may have contributed to rising prices?"

Yes 17.6%, no 69.9%, no response 12.5%.

The rest of the questions had to do mostly with opinions regarding the over-use, under-use or appropriate-use of the Federal Reserve's policy instruments, and the results -- too detailed for further showing here -- can be seen in a Committee print.

The disappointment of Chairman Patman with the results as a whole is indicated by the opening sentence of a personal statement he released with the announcement:

"While the large number of economists responding expressed sympathy with the aims of the Federal Reserve's tight money policy, a considerable minority indicated varying degrees of doubt as to the techniques employed. . ."

What weight these showings may deserve is anybody's guess. They -- and they are the only things of the kind that the author of this paper has found, though undoubtedly more such items exist -- are given here merely for perspective. Maybe they are just a measure of luck -- in the past.

If any generalization can be made about the "public understanding problems" of the Federal Reserve, on the basis of experience over the System's

lifetime, it probably is this: those problems wax and wane with the business cycle.

The generalization may be bolstered by a concise account of the experiences the Board went through in just one short era.

First, Congressional critics attacked the Board in one breath for not preventing inflation from raising the cost of living, and in another breath assailed it for increasing interest rates to stem the inflation and its price consequences.

Then, when the Board (and the upward movement in interest rates) remained unresponsive to Congressional criticism that was directed to the public, "pressure" was applied directly to members of the Board. Next, by way of intimidation, a "full report to Congress" was required.

The Board's policy nevertheless continued unchanged, so Congressional opponents tried different tactics.

As step one, they introduced bills to enlarge or "pack" membership on the Board, and also to revise System procedures in a manner that would virtually assure policies directed toward lowering interest rates.

As step two, to win support for those bills, they launched an assault on the Board's reputation:

- In administrative matters, the Board was charged with reckless extravagance in expenditures, especially for salaries and building programs.

- In policy matters, it was charged with "conspiring with bankers" for the bankers' benefit, in discrimination against certain other groups in particular, while making a public pretense of administering "an impartial, general control."

- In personal matters, individual members of the Board were accused of "making a killing" in the markets by using "inside information" for speculative activity.

Throughout, the Federal Reserve fought back at its Congressional tormentors, sometimes openly. Eventually, change came over the scene as the economy declined, and, with it, the critical barrage. The critical refrain, in fact, quieted to a whisper as the economy slid into a recession and discount rates went with it to low levels, but, after a while, it began again. The rising new refrain told how the Federal Reserve had caused the economic crack-up.

Finally, though, business and employment began to pick up and an investigation of the whole cycle was launched by a Congressional committee manned by some of those who had fought most bitterly against the rise in interest rates in the beginning.

The Committee, in time, concluded that what brought on the trouble in the first place was failure of the Federal Reserve to move sooner and more strongly against inflation at the outset.

The era profiled was that of Governor (i. e., chairman) W. P. G. Harding, and the time was 1920-22. The account itself is an abridgement from a book Governor Harding wrote in 1925: The Formative Period of the Federal Reserve System.

The dangerous men, it seems, are always with us, and sometimes they make some inroads.

Then, as now, they were pushing legislative proposals intended to insure sympathetic attention for a particular occupational group the Board was accused of overlooking and even discriminating against.

That time, despite opposition by the Board, they succeeded. To their success, we are indebted for the "fair representation" on the Board, ever since, of "agricultural interests."

V Some Reflections

In whatever it does or undertakes to do in the area under discussion the Board must be mindful of the face it presents to the world and the impression it therefore will make.

Over the long haul, the impression one projects is bound to reflect one's true self, with only such distortions as are inevitable from flaws in the transmitter and the receiver. That makes it necessary, if not always pleasant, to be one's self.

Over shorter periods, other things are of course possible. Madison Avenue manipulators, playing variations on a Viennese theme, have been making unlikely Cinderellas for so many years the process is familiar from Peru, Indiana, to Dublin, Georgia.

The great fault in all this is that the initial stage, commonly called The Build-up, is always followed, in time, by the natural Fall- or the induced Tear-down. Publicity is the medium that leads to both. The Board will do well to avoid it.

Popularity, too, would be an elusive target for the Federal Reserve, and unlikely of long retention. The System all too often has a job to do that precludes it.

But the System can, however, seek from the public one valuable thing that the public does not lightly bestow for long, and that is respect.

There is no absolutely sure way of attaining or retaining respect, but there is a definite rule governing the try: to so conduct one's self as to earn

it -- or, at least, to deserve it. In observing this rule, the Board's record, in general, is excellent.

Perhaps a fair and reasonable continuing target for the Board might be projection of an image along these lines:

A body of reasonable and competent men, devoted to the interest of the public as a whole, rather than to the particular interests of particular economic, social, or political groups.

Men mindful of and favorably disposed toward desirable economic and social objectives (i. e., not just for "a stable dollar," period, but for it in the belief that it is a necessary means to achieve the social end of a higher standard of living -- and maybe, even, a higher standard of life).

Men with some compassion for humanity and its aspirations, and constructive in their approach thereto. (It is not suggested that anyone try setting audiences awash in tears. What is suggested may be possible of illustration: while it is and always will be necessary in commenting on proposed legislation to give some negative reports -- impractical, overcostly, financially unsound -- it may be possible many times (a) to make some constructive suggestions on ways of accomplishing the legislative purpose, or (b) to explain in more sympathetic terms why the proposal may hurt rather than help in achieving desired goals).

Men endeavoring in reason and moderation to contribute to the achievement of worthy objectives, but without final or absolute power to assure that the outcome will be that universally desired, especially if others do not

whole-heartedly contribute their efforts, too.

(Beware the blandishments of members of Congress and magazines that Build-up the Board or the Open Market Committee as "the most powerful little group of men in the world." They are only seeking to attract a bigger audience for the "message" they will deliver against you.)

Perhaps the whole thing can be stated more tersely in simpler and possibly more practical terms.

The ideal is to win public acceptance of the Federal Reserve's operations as worthy in purpose, reasonable and effective in execution, and administered with justice and integrity.

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The comments of the author in this section flow from a faith that "imagery" is fundamentally important.

Fortunately, a more authoritative and better-stated comment has been on the books for almost 60 years, put there by a blind Harvard historian in his stirring recital of how a few squads of Spanish horsemen overcame the Aztec empire's millions and conquered Mexico 99 years before anyone landed at Plymouth Rock.

It is not a pretty story, for it is the tale of a small band of very dangerous men toppling a great but ponderous and vulnerable institution. Put here is William H. Prescott, giving voice to his own moral:

"The fate (of the Aztec monarchy) may serve as a striking proof that a government which does not rest on the sympathies of its subjects cannot long abide; that human institutions, when not connected with human prosperity and progress, must fall -- if not before the increasing light of civilization, by the hand of violence; by violence from within, if not from without. And who shall lament their fall?"

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VI Disclosure

In one area that the subject of this paper traverses, the Board has made far more progress in recent months than has been made elsewhere in years, but there is still a distance to go.

This is the area of revelation -- or, more precisely, disclosure necessary to discharge the obligation incumbent on the Board to provide readily, at any time, an accounting for its actions in the grant or denial to applicants of privileges they seek.

In respect to bank merger and branch applications, it appears that -- until recently, at least -- the practice of the Board from the beginning of the System has been to:

- Leave discretion over all questions of revelation to the banks involved.
- Provide no information from the Board on either applications or actions -- not even in response to requests.

- Give out nothing more than eventual confirmation to the fact of a merger, well after it had been effected.

This "no revelation" practice has not been without advantages. It has, in fact, tended to keep down controversy and thereby the interest of the press, by delaying knowledge, until too late, that there was anything to be controversial about.

Thus, many small or modest-size headaches have been averted for years. But only at the risk of a monstrous headache that could blow the reputation of the institution to the point of no-return.

It is a remarkable thing, in the eyes of the author, that there has not already occurred a scandal-sized press explosion against the Board for DENYING PUBLIC'S RIGHT TO KNOW or, more specifically, SECRETLY GRANTING PRIVILEGES TO BANKERS.

A combination of circumstances has figured in the Board's escape thus far, which seem to the author as follows:

First, the applicant banks, luckily enough, have supplied just about enough information, on a sufficiently timely basis, to keep explosive pressures from building up.

(That has been true, at least, of most of the big or big-city banks, on which is centered the interest of the general press -- in distinction to the trade press, with its interest in even trivial trade matters. And it is the general press alone that is really dangerous on RIGHT TO KNOW issues.)

Second, the ever-dangerous general press has been kept largely in ignorance of the severity of Board rules by maneuvers designed to put heavy stress, in diversion of questions that might arise about those rules, on information mined from the voluntary announcements of the applicants themselves.

Third, the Board has been alert to the necessity of "bending" rules and practices when dangers of explosion have been vivid: the "National City case" got special handling in its day, and the Board authorized immediate disclosure, by "spokesman" phone calls to the strategically situated press, of the J. P. Morgan-Guaranty Trust merger approval.

But one's reputation for accounting responsibly and openly for the discharge of quasi-judicial duties behind closed doors is best not left to such chance factors, and the Board increasingly has so recognized.

In the classification of individual banks for reserve requirement purposes, the Board, since May 1960, has embarked on publication in routine (i. e., "quiet") manner on a regular basis of information sufficient to the need.

(A happy circumstance, too, for in this, as in many like matters, it would take an extraordinarily fertile brain to think of a justification for a "no revelation" policy that could pass the sort of tests that are given under the pitiless probing of press spotlights.)

Similar progress to the same extent -- which is extent enough, for the time being -- has been made regarding publication of the names of banks held by bank holding companies and also regarding applications made by holding

companies to acquire other banks.

The handling of bank holding company decisions, by steps taken gradually over a fairly short period of years, has been carried possibly to the point of perfection -- in respect, at least, to disclosure procedures.

For those procedures now provide not only the speedy disclosure of decisions themselves but, of equal importance, simultaneously provide the reasons for the decisions disclosed.

The Board must, of course, be ready always to account for and explain, justify or defend every action of every kind it takes, and one suggestion is offered here, accordingly:

That authorization be granted immediately, at least to the Assistants to the Board, to provide, in response to requests, information on (a) applications received and (b) decisions, plus a general statement of reasons therefor, in bank merger and branch cases .

If that suggestion is not accepted, request is here made that the Board furnish to its Assistants a short statement, for the benefit of those making the requests, that will explain why the information cannot be granted.

(The author has tried hard but vainly to formulate an explanation of the kind himself, resting refusal of this information on the only ground of justification he has been able to conceive: that disclosure would wreak such mischief to business as to be against the public interest, and therefore would be unjustifiable since the public interest is the overriding question.)

Already, the Board has gone part way toward the point suggested. It did so when it decided, very recently, to make known decisions -- and applications also, in the author's understanding -- in merger cases.

The decisions, in any event, are now listed in a release (identification symbol K. 3) put out once each week covering all determinations (approvals and disapprovals) accumulated during the week preceding the release.

A brief statement indicative of the reasons for approvals could easily be furnished at the time of decision to the Board's Assistants, for use in meeting any inquiries arising.

The Division of Bank Examinations, which must prepare such statements for eventual publication in the annual report, in order to meet requirements of the recent merger law, would need merely to furnish the Board's Assistants with timely copies.

(The law does not require the Board to state reasons for disapprovals in merger cases, and no statements regarding disapprovals will be prepared by the Division. Disapprovals, however, present no problem: they can be explained sufficiently by the Board's Assistants, as a test incident has indicated, without further ado -- and without breaching present rules.)

In making the request stated, the author of this memorandum is prompted solely by belief that refusing to supply the information specified respecting branch or merger cases entails unwarranted risks of a kind already described.

It is not contended here that supplying the information holds other values for the Board, for the author's opinion is that it does not.

In his view, decisions made in a quasi-judicial capacity seldom bring anything except headaches, and sometimes carry a potential for controversy that is appalling.

It would not be realistic to expect the winner of an approval to be grateful, particularly in an "uncontested" matter: it would always be hard for him to "understand" any other outcome.

It would not be realistic, either, to expect the loser in a "contested" matter -- whether the loser be the applicant or his opponents -- to understand. Naturally, he will suffer the temptation to denounce your obviously (in his eyes) erroneous and prejudiced decision.

And it would be wholly unrealistic to expect the loser in an "uncontested" case to understand anything, except perhaps what villains you are (again, in his eyes). He is the most likely of all to wrestle with temptation to denounce you, and most likely to lose the match.

Chances are that any reasons the Board is willing to give for its decisions in any of these cases -- except that of the winner in uncontested matters -- will be better, from the Board's standpoint, than the reasons a disappointed applicant or his opponent is likely to give.

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VII Postscript

There are many matters that are common to communications and to monetary policy.

Both are arts, in the sense that they are concerned with (and dependent upon) ideas -- and people -- rather than things.

Put the same combination of chemical elements together in a test tube and you will always get the same reaction. You can never count on that in monetary policy or in communications.

For that reason, no one can really lay out a schedule or calendar for communications any more than for monetary policy itself.

Each move in communications, as in monetary policy, must be determined by circumstances -- and needs -- as they develop, and it must be shaped accordingly. That is what this paper has been trying to say.

The requirements for good communications, however, are easier to set out than those for good monetary policy, because they are simpler, and there are just four of them:

Purpose, message, presentation, tone.

Tone is the only one that was not mentioned specifically in a fundamental rule of communications that was set out in this paper far back along the way, so a few words will be added in respect to it.

In the King James version, there appears very early, in the Gospel according to Matthew, a verse that reads: "Elesed are the meek: for they shall inherit the earth."

To many readers, for semantic reasons, that seems so implausible that it impairs the credibility of the entire Book.

In the Bibles of the French, the same verse, translated literally, begins another way: "Happy those who are the debonair..."

It can give an American reader the pleasantly surprised feeling of having come upon a memorable incidence of Gallic insouciance.

But the truth is, of course, that the persons with whose prospects both versions are concerned are one and the same, the "gentle and courteous."

They may not be especially numerous, but the gentle and courteous should be good people for the Federal Reserve to string along with, on every possible occasion.

Of course these people may never get anywhere, despite the powerful forecast they have going for them, and certainly there is no convincing evidence as yet that they will in fact inherit the earth.

Nevertheless, it will be better for the earth if they do.

Immediate Explanations

Follow up explanations

Strategic matters - pgs

is the King James version, there appears very clearly in the Greek text according to Matthew, a verse that reads: "they shall inherit the earth." To many readers, for semantic reasons, that seems to imply that it implies the credibility of the entire book. In the Bible of the French, the same verse, translated literally begins another way: "Happy those who are the laborers..." It can give an American reader the pleasantly surprised feeling of having come upon a memorable incidence of Gallic innocence. But the truth is, of course, that the persons with whose prospects both versions are concerned are one and the same, the "gentle and courteous." They may not be especially numerous, but the gentle and courteous should be good people for the Federal Reserve to string along with, on every possible occasion. Of course these people may never get anywhere, despite the power that is theirs, they have going for them, and certainly there is no convincing evidence as yet that they will in fact inherit the earth. Nevertheless, it will be better for the earth if they do.