

William McChesney Martin, Jr., Papers

Box 24/Folder 4

House

Series V, Subseries C

Sense of Congress, resolutions

Insert after line 4 on page 2:

SEC. 102. It is the sense of Congress that the Federal Reserve System, while pursuing its primary mission of administering sound monetary policy, shall, to the maximum extent consistent therewith, use its powers so as to permit the Treasury to market bonds at no higher than 4½% interest; that the System shall bring about needed future monetary expansion by purchasing U.S. securities, of varying maturities, rather than by other methods; (and that, where necessary, it shall offset purchases by it of U.S. securities by corresponding adjustments of bank reserve requirements.)

SEC. 103. The Federal Reserve System and the Secretary of the Treasury shall make ~~semi-~~annually, to the Speaker of the House of Representatives and the President of the Senate a full and complete report of their operations in pursuance of the provisions of Section (*) of this Act, including recommendations (if any) of legislative actions further to facilitate the economical and efficient management of the public debt.

and renumber the other sections of Title I accordingly.

Accordingly it is the hope of the Committee and we believe the Congress
that the monetary officials and debt managers of our country will
in the exercise of their responsibility give careful consideration to the
achievement of all of these objectives, ~~to the extent that it is possible~~ their
~~discharge of their responsibilities.~~

Provided that, the monetary and debt management officials of the Government shall, in discharging their responsibilities take fully into account the importance of promoting the goals of the Employment Act of 1946, achieving a maximum sustainable rate of economic growth, maintaining reasonable stability in the purchasing power of the dollar, and assuring that the cost of servicing the public debt is kept to the minimum consistent with the preceding objectives.

July 17, 1959.

Dear Bob:

Herewith are the two drafts we previously discussed—one for the bill and the other for the report. I would see no objection to having the first one read: "It is the sense of the Congress that the monetary and debt management officials . . ."

I will be back Monday evening.

Sincerely yours,

(Signed) Bill

Wm. McC. Martin, Jr.

The Honorable Robert B. Anderson,
Secretary of the Treasury,
The Treasury Department,
Washington 25, D. C.

Enclosures (2)

The Committee recognizes the importance of maintaining reasonable stability in the purchasing power of our money. *He must do all in our power* in order to protect the increasing number of our citizens who are dependent upon some form of savings, such as those represented by social security, retirement plans, insurance annuities, and the like; in order to insure compliance with the ~~the~~ Employment Act and to maintain the continuity of employment; in order to insure a continuation of sufficient volume of savings to meet as nearly as possible our investment requirements, and to maintain the confidence here and abroad in our currency.

The Committee also recognizes the necessity of our *keeping the* ~~achieving~~ the *interest charged* management of our national debt as economically as possible so as not to unduly increase the burden of taxation.

The Committee also recognizes that a continuing rise in the level of interest rates is not within itself ~~(a predominant)~~ cure for inflationary pressures and that in a complex economic society many ^{factors} ~~actions~~ must be ^{ed} weight at the same time.

There may be those who would say that the action of this Committee will simply have the effect of *not or predicting* ~~continuing~~ a rising pattern of interest rates. This is not the case.

The monetary officials should discharge their responsibilities in a manner consistent with these objectives to the maximum degree that is feasible.

It is the sense of Congress that monetary and debt management officials of the Government shall, in discharging their responsibilities, take fully into account the importance of promoting a continuity of employment opportunities, achieving the maximum sustainable rate of economic growth, maintaining reasonable stability in the purchasing power of the dollar and assuring that the cost of managing the public debt is kept to the minimum consistent with these vital national objectives.

Concurrent Resolution Expressing the
Sense of the Congress with Respect to
the Interrelationship of Federal Re-
serve Monetary Policy and the Manage-
ment of the Public Debt

Whereas the interest charge on the national debt has grown progressively higher, and now stands at more than \$8 billion annually; and

Whereas the administration has been unable to reduce the amount of the debt held by the commercial banks below the amount held in 1953; and

Whereas the proportion of the national debt which is short-term, and thus of greater inflationary potential, has increased since 1953; and

Whereas the Federal Reserve System has consistently followed, and stated its intention to continue to follow, a policy of creating necessary increases in the money supply by lowering reserve requirements, rather than by purchases of Government securities, and necessary decreases through sales of Government securities rather than by raising reserve requirements; and

Whereas this method makes Government securities unattractive to investors by bringing about undue downward fluctuations in the prices of Government securities, adds to the interest burden on the taxpayer, and exposes the Treasury to almost constant refunding operations; and

Whereas greater reliance on purchase or retention of Government obligations by the Federal Reserve System, where sound monetary policy permits, is essential: Now, therefore, be it

Resolved by the House of Representatives (the Senate concurring), That the Federal Reserve System, while pursuing its primary mission of administering a sound monetary policy, should, to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt; that purchases of Government securities rather than further lowering of reserve requirements should be utilized to the greatest extent possible for attaining needed monetary expansion: and that the Federal Reserve System should promptly and fully explore methods whereby use of the power to set reserve requirements may become a more useful and effective anti-inflationary tool.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 15, 1959.

To Chairman Martin
From Mr. Hackley

Subject: Effect of House Concurrent
Resolution 196 regarding Federal
Reserve policies

Legal effect. - A "concurrent" resolution, unlike a "joint" resolution, is not approved by the President and does not have the effect of law. It evidences only the sense or purpose of Congress. Consequently, House Concurrent Resolution 196, introduced by Representative Reuss on June 4, 1959, would not, if adopted, be legally binding on the Board and the Federal Open Market Committee.

Practical effect. - Nevertheless, as a practical matter, the proposed Resolution might be regarded as a Congressional directive to the Board and the Committee to conform their policies to those indicated in the Resolution. In recent years, the Board has often been referred to as an "agent" of Congress. It may be questioned whether the Board is any more an agent of Congress than any other governmental agency including the executive departments; all agencies and departments derive their powers from statutes of Congress. It is true, however, that in the Federal Reserve Act Congress has clearly vested in the Federal Reserve System an "independence" from executive control that does not characterize the so-called executive departments. In view of this fact, disregard of the Resolution by the System might very well be viewed as a flouting of the will of Congress by its "agent". Such disregard could make the System subject to criticism by Congress and lead to the enactment of effective legislation curtailing the powers and exercise of independent judgment by the Board and the Federal Open Market Committee.

Inconsistency with Present Law. - On its face, the Resolution might be regarded as stating no more than the policy followed by the System at present. Thus, it says that the System, "while pursuing its primary mission of administering a sound monetary policy, should to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt". That, it may be said is what the System does now. Moreover, the phrase "to the maximum extent consistent therewith" might be construed as allowing exercise of discretion by the System. Similarly, the Resolution provides only that purchases of Government securities, rather than lowering of reserve requirements, shall be used "to the greatest extent possible" for attaining needed monetary expansion.

However, it seems clear from the language of the Resolution, including its "whereas" clauses, and from its legislative history that the Resolution would be intended to restrict the exercise of judgment by the System in several respects in a manner wholly at variance with present law.

First, while the Resolution would not expressly require open market purchases of Government securities for the purpose of supporting their market, the tenor of the resolution is in that direction. Thus, the "whereas" clauses, after stating that the System has consistently followed a policy of increasing the money supply by lowering reserve requirements rather than by purchasing Government securities, states that "this method makes Government securities unattractive to investors by bringing about undue downward fluctuations in the prices of Government securities." On the floor of the House, Congressman Reuss made it perfectly clear that one of the purposes of the Resolution would be to have the System purchase long-term Government securities as a means of maintaining a lower interest rate on such securities in order to facilitate management of the public debt.

Second, the Resolution is clearly intended to limit the flexibility that now exists in the use of the instruments of monetary control by expressly requiring greater use of open market purchases of Government securities, rather than lowering of reserve requirements, in order to achieve needed monetary expansion. In other words, the discretion the System now has in determining whether open market purchases or reductions in reserve requirements are best adapted under particular circumstances in order to increase the money supply might be regarded as expressly restricted. This intent is indicated by one of the "whereas" clauses which states that it is "essential" that greater reliance be placed on purchase or retention of Government obligations.

Finally, the last clause of the proposed resolution suggests that changes in reserve requirements be used only as an "anti-inflationary tool", with the implication that reductions in reserve requirements should seldom, if ever, be employed as a means of providing needed expansion. Such a construction would, of course, impair the Board's discretion and the flexibility with which changes in reserve requirements might be used. In this respect, it would be inconsistent with the language of present law that authorizes the Board to change reserve requirements "in order to prevent injurious credit expansion or contraction."

In a much broader sense, the Resolution would be inconsistent with the clear intent of present law to vest in the System full discretion in the exercise of its powers with respect to open market operations and reserve requirements. For example, the law requires the Federal Open Market Committee to regulate open market purchases and sales "with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country"; and the legislative history of the Banking Act of 1935 makes it clear that complete discretion was meant to be vested in the Committee. The Resolution would suggest that open market operations be directed toward "economical and efficient management of the public debt." In a similar manner, the Resolution would curtail the Board's discretion in determining how to use its authority with respect to reserve requirements.

Congress could, of course, by statute undertake to determine the exact manner in which open market operations and changes in reserve requirements should be utilized in order to influence economic conditions. It could convert the proposed Concurrent Resolution into statutory law (as Congressman Reuss has proposed in the form of an amendment to the bill before the Ways and Means Committee). If it did so, however, Congress would in effect be altering the fundamental nature of the Federal Reserve System; the Board and the Open Market Committee would no longer be bodies of experts in the field of monetary and credit regulation, with authority to exercise independent judgment in the light of current conditions.

Summary. - The proposed Concurrent Resolution would have no legally binding effect, but as a practical (or political) matter it could be regarded as an expression of a Congressional directive to the System. If so regarded, and if followed in practice, it would accomplish a fundamental change in the philosophy of the System, directly at variance with the language and intent of present law. Yet, opposition to the Resolution, or disregard of it if it is adopted, would involve taking a calculated risk of action by Congress to convert the Resolution into positive legislation.

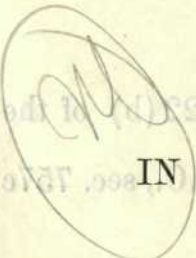
Howard H. Hackley

CONFIDENTIAL COMMITTEE PRINT

JUNE 30, 1959

86TH CONGRESS
1ST SESSION

H. R.



IN THE HOUSE OF REPRESENTATIVES

JUNE 30, 1959

Mr. _____ introduced the following bill; which was referred to the Committee on _____

A BILL

To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Public Debt Management
4 Act of 1959".

TITLE I—IN GENERAL

6 SEC. 101. The Second Liberty Bond Act, as amended,
7 is amended by adding at the end thereof the following new
8 section:

9 "SEC. 25. In the case of any offering of bonds issued
10 or to be issued under this Act, the maximum limits on the

1 interest rate or the investment yield or both may be exceeded
2 upon a finding by the President with respect to such offering
3 that the national interest requires that such maximum limits
4 be exceeded.”

5 SEC. 102. (a) Paragraph (2) of section 22 (b) of the
6 Second Liberty Bond Act, as amended (31 U.S.C., sec. 757c
7 (b) (2)), is amended to read as follows:

8 “(2) The Secretary of the Treasury, with the approval
9 of the President, is authorized to provide by regulations:

10 “(A) That owners of series E and H savings bonds
11 may, at their option, retain the bonds after maturity,
12 or after any period beyond maturity during which such
13 bonds have earned interest, and continue to earn interest
14 upon them at rates which (subject to section 25) are
15 consistent with the provisions of paragraph (1).

16 “(B) That series E and H savings bonds on which
17 the rates of interest have been fixed prior to such regu-
18 lations will earn interest at higher rates which (subject
19 to section 25) are consistent with the provisions of
20 paragraph (1).”

21 (b) The heading and first sentence of section 454 (c)
22 of the Internal Revenue Code of 1954 (relating to matured
23 United States savings bonds) are amended to read as follows:

24 “(c) **MATURED UNITED STATES SAVINGS BONDS.**—In
25 the case of a taxpayer who—

1 “(1) holds a series E United States savings bond
2 at the date of maturity, and

3 “(2) pursuant to regulations prescribed under the
4 Second Liberty Bond Act, (A) retains his investment
5 in such series E bond in an obligation of the United
6 States, other than a current income obligation, or (B)
7 exchanges such series E bond for another nontransfer-
8 able obligation of the United States in an exchange upon
9 which gain or loss is not recognized under section 1037
10 (or so much of section 1031 as relates to section 1037),
11 the increase in redemption value (to the extent not previ-
12 ously includible in gross income) in excess of the amount
13 paid for such series E bond shall be includible in gross income
14 in the taxable year in which the obligation is finally re-
15 deemed or in the taxable year of final maturity, whichever is
16 earlier.”

17 SEC. 103. Subsection (i) of section 22 of the Second
18 Liberty Bond Act, as amended (31 U.S.C., sec. 757c (i)), is
19 amended by inserting after the third sentence thereof the follow-
20 ing: “Relief from liability shall be granted in all cases where
21 the Secretary of the Treasury shall determine, under rules
22 and regulations prescribed by him, that written notice of
23 liability or potential liability has not been given by the
24 United States, within ten years from the date of the erroneous
25 payment, to any of the foregoing agents or agencies whose

1 liability is to be determined: *Provided*, That no relief shall
 2 be granted in any case in which a qualified paying agent has
 3 assumed unconditional liability to the United States.”

4 SEC. 104. The following provisions of law are amended
 5 by striking out the words “on original issue at par” and
 6 inserting in lieu thereof the words “on original issue at the
 7 issue price”:

8 (1) Section 6 (g) (5) of the Act of March 24,
 9 1934, as amended (22 U.S.C., sec. 1393 (g) (5)) ;

10 (2) Section 201 (d) of the Act of August 14, 1935,
 11 as amended (42 U.S.C., sec. 401 (d)) ;

12 (3) Section 904 (b) of the Act of August 14, 1935,
 13 as amended (42 U.S.C., sec. 1104 (b)) ;

14 (4) Section 15 (b) of the Act of August 29, 1935,
 15 as amended (45 U.S.C., sec. 2280 (b)) ;

16 (5) Section 209 (e) (2) of the Act of June 29,
 17 1956 (23 U.S.C., sec. 173 (e) (2)).

18 SEC. 105. (a) Section 3701 of the Revised Statutes
 19 (31 U.S.C., sec. 742) is amended by adding at the end
 20 thereof the following: “This exemption extends to every
 21 form of taxation that would require that either the obliga-
 22 tions or the interest thereon, or both, be considered, directly
 23 or indirectly, in the computation of the tax, except non-

1 discriminatory franchise or other nonproperty taxes in lieu
2 thereof imposed on corporations and except estate taxes or
3 inheritance taxes.”

4 (b) The following provisions of the Second Liberty
5 Bond Act, as amended, relating to the tax-exempt status of
6 obligations of the United States, are repealed, without chang-
7 ing the status of any outstanding obligation:

8 (1) Subsections (b) and (d) of section 5 (31
9 U.S.C., sec. 754 (b) and (d));

10 (2) The second and third sentences of section 7
11 (31 U.S.C., sec. 747);

12 (3) Subsection (b) of section 18 (31 U.S.C., sec.
13 753 (b));

14 (4) The first sentence of subsection (d) of section
15 22 (31 U.S.C., sec. 757c (d)).

16 SEC. 106. The amendment made by section 101 shall
17 apply, in the case of bonds issued before the date of the
18 enactment of this Act, only in the case of bonds issued under
19 section 22 of the Second Liberty Bond Act, as amended.
20 In no case shall the interest rate, or investment yield, on
21 any bond be changed pursuant to the amendments made by
22 this title for any period which begins before June 1, 1959.

1 TITLE II—INCOME TAX TREATMENT OF CER-
2 TAIN EXCHANGES OF UNITED STATES
3 OBLIGATIONS

4 SEC. 201. Part III of subchapter O of chapter 1 of the
5 Internal Revenue Code of 1954 (relating to common non-
6 taxable exchanges) is amended by adding at the end thereof
7 the following new section:

8 “SEC. 1037. CERTAIN EXCHANGES OF UNITED STATES
9 OBLIGATIONS.

10 “(a) GENERAL RULE.—When so provided by regula-
11 tions promulgated by the Secretary in connection with the
12 issue of obligations of the United States, no gain or loss shall
13 be recognized on the surrender to the United States of obliga-
14 tions of the United States issued under the Second Liberty
15 Bond Act in exchange solely for other obligations issued
16 under such Act.

17 “(b) APPLICATION OF SECTION 1232.—

18 “(1) EXCHANGES INVOLVING OBLIGATIONS ISSUED
19 AT A DISCOUNT.—In any case in which gain has been
20 realized but not recognized because of the provisions of
21 subsection (a) (or so much of section 1031 (b) as
22 relates to subsection (a) of this section), to the extent
23 such gain is later recognized by reason of a disposition
24 or redemption of an obligation received in an exchange
25 subject to such provisions, section 1232 shall apply to

such gain as though the obligation disposed of or re-
deemed were the obligation surrendered to the Govern-
ment in the exchange rather than the obligation actu-
ally disposed of or redeemed.

“(2) EXCHANGES OF TRANSFERABLE OBLIGATIONS

ISSUED AT NOT LESS THAN PAR.—In any case in which
subsection (a) (or so much of section 1031 (b) or (c)
as relates to subsection (a) of this section) has applied
to the exchange of a transferable obligation which was
issued at not less than par for another transferable obli-
gation, the issue price of the obligation received from the
Government in the exchange shall be considered for pur-
poses of applying section 1232 to be the same as the
issue price of the obligation surrendered to the Govern-
ment in the exchange.

“(c) CROSS REFERENCES.—

“(1) For rules relating to the recognition of gain or
loss in a case where subsection (a) would apply except
for the fact that the exchange was not made solely for
other obligations of the United States, see subsections
(b) and (c) of section 1031.

“(2) For rules relating to the basis of obligations of
the United States acquired in an exchange for other obli-
gations described in subsection (a), see subsection (d) of
section 1031.”

(b) The table of sections for part III of subchapter O
of chapter 1 of the Internal Revenue Code of 1954 is
amended by adding at the end thereof the following:

“Sec. 1037. Certain exchanges of United States obligations.”

1 (c) Section 1031(b) of such Code (relating to gain
2 from exchanges of property not solely in kind) is amended
3 by striking out "the provisions of subsection (a), of section
4 1035(a), or of section 1036(a)," and inserting in lieu
5 thereof "the provisions of subsection (a), of section 1035
6 (a), of section 1036(a), or of section 1037(a),".

7 (d) Section 1031(c) of such Code (relating to loss
8 from exchanges of property not solely in kind) is amended
9 by striking out "the provisions of subsection (a), of section
10 1035(a), or of section 1036(a)," and inserting in lieu
11 thereof "the provisions of subsection (a), of section 1035(a),
12 of section 1036(a), or of section 1037(a),".

13 (e) Section 1031(d) of such Code (relating to basis
14 in the case of exchanges of property held for productive
15 use or investment) is amended by striking out "this sec-
16 tion, section 1035(a), or section 1036(a)," each place it
17 appears in the first and second sentences thereof and insert-
18 ing in lieu thereof "this section, section 1035(a), section
19 1036(a), or section 1037(a),".

20 SEC. 202. Section 4(a) of the Public Debt Act of 1941,
21 as amended (31 U.S.C., sec. 742a), is amended by striking
22 out "under the Internal Revenue Code, or laws amendatory
23 or supplementary thereto" and inserting in lieu thereof
24 "except as provided under the Internal Revenue Code of
25 1954".

1 SEC. 203. The amendments made by this title shall be
2 effective for taxable years ending after the date of enactment
3 of this Act.

1 Sec. 203: The amendments made by this title shall be
 2 effective for taxable years ending after the date of enactment
 3 of this Act.

Referred to the Committee on _____

June 1, 1908

By Mr. _____

other purposes
or loss for income tax purposes and for
securities to be without restriction of their
designate certain expenses of Government
to permit the Secretary of the Treasury to
to facilitate management of the public debt.

A BILL

For the Secretary
of the Treasury
H. R.

June 1, 1908

[CONFIDENTIAL COMMITTEE PRINT]

[CONFIDENTIAL COMMITTEE PRINT]

JUNE 30, 1959

86TH CONGRESS
1ST SESSION

H. R.

A BILL

To facilitate management of the public debt,
to permit the Secretary of the Treasury to
designate certain exchanges of Government
securities to be without recognition of gain
or loss for income tax purposes, and for
other purposes.

By Mr. -----

JUNE , 1959

Referred to the Committee on -----

86TH CONGRESS
1ST SESSION

H. CON. RES. 196

IN THE HOUSE OF REPRESENTATIVES

JUNE 4, 1959

Mr. REUSS submitted the following concurrent resolution; which was referred to the Committee on Banking and Currency

CONCURRENT RESOLUTION

Whereas the interest charge on the national debt has grown progressively higher and now stands at more than \$8,000,000,000 annually; and

Whereas the administration has been unable to reduce the amount of the debt held by the commercial banks below the amount held in 1953; and

Whereas the proportion of the national debt which is short term, and thus of greater inflationary potential, has increased since 1953; and

Whereas the Federal Reserve System has consistently followed, and stated its intention to continue to follow, a policy of creating necessary increases in the money supply by lowering reserve requirements, rather than by purchases of Government securities, and necessary decreases through sales of Government securities rather than by raising reserve requirements; and

Whereas this method makes Government securities unattractive to investors by bringing about undue downward fluctuations in the prices of Government securities, adds to the interest burden on the taxpayer, and exposes the Treasury to almost constant refunding operations; and

Whereas, greater reliance on purchase or retention of Government obligations by the Federal Reserve System, where sound monetary policy permits, is essential: Now, therefore, be it

1 *Resolved by the House of Representatives (the Senate*
 2 *concurring),* That the Federal Reserve System, while pur-
 3 suing its primary mission of administering a sound monetary
 4 policy, should, to the maximum extent consistent therewith,
 5 utilize such means as will assist in the economical and
 6 efficient management of the public debt; that purchases
 7 of Government securities rather than further lowering of
 8 reserve requirements should be utilized to the greatest
 9 extent possible for attaining needed monetary expansion;
 10 and that the Federal Reserve System should promptly and
 11 fully explore methods whereby use of the power to set
 12 reserve requirements may become a more useful and effec-
 13 tive anti-inflationary tool.

Referred to the Committee on Banking and Currency

June 4, 1920

By Mr. Hines

of the Budget for
said monetary policy and the management
aspect to the interrelationship of Federal Re-
serving the same of the Congress with re-

CONCURRENT RESOLUTION

For Session
Says CONCURRENT
H. CON. RES. 136

86TH CONGRESS
1ST SESSION

H. CON. RES. 196

CONCURRENT RESOLUTION

Expressing the sense of the Congress with respect to the interrelationship of Federal Reserve monetary policy and the management of the public debt.

By Mr. REUSS

JUNE 4, 1959

Referred to the Committee on Banking and Currency

This is included because
Reuss has quoted Goldweiser
as "favoring" F. R. support
of government bonds -

Excerpted from remarks of Mr. E. A. Goldenweiser before the Round Table Conference meeting of the National Industrial Conference Board, New York City, January 23, 1952, on "What Monetary Policy for the United States?"

"It is essential, logic and experience indicate, that the principle be widely understood and accepted that the fate of the dollar, which is the cornerstone of our economic life, depends to a substantial extent on the Federal Reserve's adapting its regulation of the availability and cost of money to the economic needs of the country, and that in the interest of all, public as well as private debt must pay the current cost of money as it is determined in the market.

"No change in our machinery is necessary for this purpose. Many suggestions--good, bad, and indifferent--for its improvement have been made. Some think that our salvation lies in the re-establishment of the gold coin standard, though what positive result this would have now, other than to give our enemies easier access to our gold and thereby to weaken our financial structure and increase their power directly or indirectly, to buy weapons with which to fight us, is difficult to see. Some think that the distribution of powers within the Federal Reserve System can be improved, as no doubt it can. Others believe that the Board should be reorganized, and probably it should. Still others want to increase the System's powers over bank reserves or to change the method of imposing them, or to alter their composition, or to make them applicable to all banks that accept demand deposits.

"In the long run some of these things might be adopted to advantage. But no legislation needs to be pressed at present. If reforms are to be considered now, the possibility of legislation will be both disturbing and delaying. Also there is always the possibility that such changes as will emerge from the maelstrom of confusion and compromise which is certain to rage if monetary reform is under discussion, will turn out to be in the wrong direction. Far better to make use of existing powers and existing machinery. Their imperfections are no greater than those of most human institutions and their performance will be no better, and no worse, than the quality of their administrators."

REUSS-CLARK RESOLUTION

A resolution introduced jointly by Senator Clark and Congressman Reuss would express the sense of the Congress that to the extent consistent with a sound monetary policy, the Federal Reserve should "utilize such means as will assist in the economic and efficient management of the public debt." The resolution would specifically recommend that "purchases of Government securities rather than further lowering of reserve requirements . . . be utilized to the greatest extent possible for attaining needed monetary expansion."

While this subject is one on which the Federal Reserve authorities should comment, the following points might be noted:

(1) The applicability of the basic recommendation - that purchases of Governments rather than reductions in reserve requirements be utilized to accommodate desirable monetary expansion - is questionable during the present period of high and rising business activity. So long as credit demands are expansive and business activity continues upward, a reduction in member bank reserve requirements is clearly inappropriate. It follows, therefore, that any additional reserves needed to support desirable monetary growth, consistent with a sound monetary policy, would be furnished either through open market operations or loans to member banks. Inasmuch as lending to member banks provides only temporary reserves to the banking system, one would expect permanent additions to the reserve base to represent purchases of Government securities by the Federal Reserve. Moreover, during a period of recession, when reductions in reserve requirements are appropriate, Treasury problems of debt management usually are minor.

(2) In my judgment, the Federal Reserve during my tenure as Secretary of the Treasury has, to the extent consistent with sound monetary policy, assisted in the economical and efficient management of the public debt. This assistance has been partly in the form of furnishing valuable information and advice pertaining to market conditions, and partly through minimizing credit policy moves that might disturb the market during a period of Treasury financing. Indeed, the desire of System authorities to avoid "rocking the boat" during financings has at times impinged upon the flexibility of monetary policy.

(3) The most important contribution that Federal Reserve authorities can make to economical and effective debt management is by pursuing monetary policies properly conceived to promote a stable price structure and relatively full and efficient use of our economic resources. The attainment of these two objectives would assure the conditions most suited to effective debt management. Anything that tends to impair Federal Reserve flexibility in use of its credit instruments impedes the attainment of such conditions.

Final Doc. P. 1
Gene Use P. 1, 2, 3, 7

(M)

Summary Statement of
Objections to the Reuss Amendment
to the Public Debt Bill

Proposed amendment: Add a new section 8, as follows:

"Sec. 8. It is the sense of Congress that the Federal Reserve System, while pursuing its primary mission of administering a sound monetary policy, should, to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt; that the System, to the greatest extent possible, should bring about needed future monetary expansion by purchasing U. S. securities, of varying maturities, rather than by further lowering bank reserve requirements; and that the System should promptly and fully explore methods whereby use of the power to raise reserve requirements may become a more useable and effective anti-inflationary tool."

1. The amendment is unnecessary, since the Federal Reserve in its conduct of monetary policy now endeavors to "assist in the economical and efficient management of the public debt" to the extent consistent with a sound monetary policy.
2. The provisions relating to the lowering of reserve requirements would seem to conflict with existing law and with new legislation (S. ¹¹²⁰ ~~1160~~), already passed by the Senate and ^{both} ~~voted out for consideration by~~ the House, that provide for flexibility in the power of the Board of Governors to raise or lower reserve requirements. Provisions of S. ¹¹²⁰ ~~1160~~ might necessitate some lowering of reserve requirements.
 - (a) Lowering of reserve requirements in modest amounts may be needed at times in the future to make available reserves to cover the long-term growth needs for bank credit and money or the effect of a gold outflow in reducing the reserve base.

- (b) To supply additional needed reserves entirely through Federal Reserve purchase of U. S. securities with no lowering of reserve requirements would in no way increase the holdings of Government securities by the banking system as a whole (member bank and Federal Reserve Banks combined) in order to provide an appropriate money supply. And if reserve requirements were raised to higher levels, it might actually cause some reduction in such holdings, because if member banks hold higher reserves they would need fewer Government securities to cover liquidity earnings needs.
 - (c) Some lowering of reserve requirements may be needed to make it possible for banks to obtain sufficient earnings to provide adequate services to the public and to maintain capital positions essential for the protection of deposits.
3. The provision relating to the purchase of varying maturities of securities by the Federal Reserve would either be unnecessary or would be an attempt to prescribe operating procedures that could interfere with the proper administration of monetary policy, with debt management, and with the effective functioning of Government securities market.
- (a) It would be unnecessary because the Federal Reserve System can and does operate in varying maturities whenever deemed appropriate to facilitate Treasury financing, consistent with the purposes of monetary policy and with the effective functioning of the Government securities market.

- (b) Present operating procedures of confining open market operations largely to the short-term sectors of the market were adopted in the light of years of experience with other procedures and after an intensive study of the functioning of the Government securities market and the impact of Federal Reserve operations on that market. The procedures now followed were adopted by the Federal Open Market Committee in 1953 and have been reaffirmed each year. They are working rules for the management of the account and are not immutable; variations can be authorized by the Committee at any time.
- (c) Operations in short-term securities are appropriate because the bulk of System operations to supply or absorb reserves, though very large, are for temporary purposes and are shortly reversed. Confining such operations to short-term securities keeps to a minimum their impact on the structure of prices among issues of varying maturities as determined by the market forces of demand and supply.
- (d) Operations in varying maturities, while they could cause erratic short-run fluctuations, would have little long-run impact upon the structure of interest rates. Because of the high degree of fluidity as between the various maturity sectors of the market, fluctuations of any magnitude in one sector are usually transmitted with considerable promptness to other sectors.

- (e) If Federal Reserve should attempt through operations in long-term bonds to have a substantial and continued impact on long-term rates, the volume of operations would have to be very large with heavy offsetting sales of short-term securities in order to avoid undue additions to the reserve supply. They would greatly increase the liquidity of the economy by (1) making outstanding bonds readily convertible into money and (2) by adding to the market supply short-term securities. Thus the inflationary potential would be enlarged even though the volume of bank reserves was not increased. In the end they would have little net effect upon either the level or structure of rates.
- (f) Fundamentally, the objection to Federal Reserve operations in longer-term securities, is that they interfere with market determination of interest rates that serve to bring about adjustments in investment and saving appropriate and essential for the maintenance of growth and stability.
- (g) It is preferable that variations in the structure of the market-held debt (i.e. other than those held by Government funds and the Federal Reserve Banks) be determined by the Treasury in its debt-management operations rather than the Federal Reserve.

Detailed Comments on the Reuss Amendment

The suggestion has been made that Congress direct the Federal Reserve System to make reserves available for appropriate monetary expansion through the purchase of United States Government securities, rather than through reductions in reserve requirements. As proposed to the Committee, this direction would not require the System to make any purchases in periods when strong credit demands were pressing against the supply of funds in the market and additional bank credit and monetary expansion would merely create inflationary pressures.

In this form it is unlikely that such a direction from a Congress would have any substantial effect on the course of interest rates in the period immediately ahead. While it is impossible to anticipate economic events, we appear to be in a period of vigorous recovery, which has already carried us to record levels of output and activity in many areas. In the light of the substantial additions to the money supply which took place last year and which have already occurred this year, it seems unlikely that any substantial addition to the monetary base would be called for under the over-riding objective expressed of administering a sound monetary policy. Therefore, whatever the merits of a Congressional direction to the Federal Reserve as a long-term matter, your Committee should recognize that the adoption of a provision of this sort would probably not have any effect on Federal Reserve policy or on the Government securities market in the near-term future.

Over the longer term, the effect of a provision of this kind would depend upon its exact wording and its position with respect to existing law and other pending legislation. As you know, the Senate ^{and House both have passed} ~~has recently passed,~~ and ~~the House Banking and Currency Committee~~ [↑] ~~has recently reported out favorably,~~ a bill (S. 1120) directed primarily to the structure of reserve requirements. ~~In~~ ^{Under} ~~the form in which this bill, passed the Senate,~~ some reduction in the reserve requirement percentages presently applicable to central reserve city banks, would be unavoidable. Furthermore the question of whether the authority granted the Board in that legislation, to permit banks to count their vault cash as a part of their legal reserves, constitutes a "lowering of bank reserve requirements," would have to be resolved.

Apart from these technical questions, the fundamental issue of whether the basic authority in the Federal Reserve Act to increase or decrease reserve requirements, reaffirmed in the legislation mentioned above, supersedes or would be superseded by the proposed amendment to the debt management legislation under consideration, would have to be determined. It would be impossible, of course, to make such a determination until the exact language of both bills was finally settled, and it might be extremely difficult even then. If it were determined that the proposed amendment to

del't management
 the ~~present~~ bill directing the Federal Reserve to operate in a certain way superseded the provisions of the Federal Reserve Act, as amended by S. ¹¹⁷⁰1160, then the effect would be to invalidate an important portion of the Federal Reserve Act. On the other hand, if S. ¹¹⁷⁰1160 were determined to be controlling, we might well find ourselves in the position of taking actions at some time in the future, in accordance with the provisions of S. ¹¹⁷⁰1160, which would appear to be directly contrary to the policies directed in the proposed amendment.

~~As Congressman Reuss pointed out in his testimony before this Committee, he introduced a concurrent resolution (H. Con. Res. 196) earlier this month to substantially the same effect as the amendment he now proposes to this bill; and this resolution has been referred to the House Committee on Banking and Currency.~~

H It is recognized that it is altogether appropriate for Congress to enact any ^{law} ~~legislation~~ that it chooses with respect to the operation of the Federal Reserve System; and, referring to the statement that I have made many times, I will do my best, as long as I am Chairman of the Board to carry out any ^{changes which may be made in} ~~mandate~~ which we ^{the} ~~receive from the Congress.~~ I would urge in the public interest, ^{statutory directives} however, that the Congress exercise the greatest care to avoid conflicting ~~mandates~~ because it is inevitable that legislation in this area has a profound effect on the smooth functioning of our financial system.

There is one other point that might be made here. The objective of the debt management legislation proposed by the President is fundamentally to remove overly rigid statutory limitations upon the Treasury in carrying out its debt management responsibilities flexibly in the public interest. It would be indeed inconsistent to enact legislation that, on the one hand, provided greater discretionary latitude in managing the public debt and, on the other hand, contained provisions limiting the ability of the monetary authorities to exercise their responsibilities flexibly.

With respect to the merits of providing for necessary and desirable monetary expansion through additions to the Federal Reserve portfolio, as contrasted to reductions in reserve requirements, there are a few points which I shall make very briefly; first, the net effect on the Government securities holdings of the banking system would undoubtedly be considerably less than might at first appear. Relatively high reserve requirements and correspondingly high Federal Reserve holdings of Government securities tend to cause the commercial banks to minimize their investments in Government securities. Lower reserve requirements and correspondingly lower Federal Reserve System holdings of Government securities make possible and encourage somewhat larger holdings of Government securities on the part of commercial banks. For this reason, it would be a mistake to assume that the Federal Reserve Banks and the

commercial banks, taken together, would hold a substantially larger amount of the public debt in ~~any~~ ~~cases~~ ~~where~~ reserve requirements are maintained in the period ahead rather than lowered. Higher reserve requirements, on the other hand, might result in a lower combined total of Federal Reserve and commercial bank holdings.

Member banks do not receive any interest on the reserve balances which they are required to carry with the Federal Reserve. Hence, the higher the percentage that these reserves represent of their total resources, the lower their net earnings tend to be, other things being equal. All of the bank supervisory authorities are continually concerned that banks maintain adequate capital to protect first their depositors, and second, the resources of the Federal Deposit Insurance Corporation which guarantees a substantial portion of all commercial bank deposits. An adequate rate of return on capital invested in commercial banks is essential to the maintenance of sound capital ratios. Hence, quite apart from any concern we might feel for equity and fairness for those who have made funds available to provide for capital for commercial banks in the past, we must recognize that if bank capital is to grow in the future to provide an adequate protective cushion for an expanding volume of deposit liabilities, bank earnings must be sufficient to attract further capital investment. For this reason, the levels to which reserve requirements can be raised, or at which they should be maintained, must be determined in consideration of the effect on capital structure of the banking system.

A somewhat related problem stems from the fact that we have always had and still maintain in this country what we call the dual banking system; that is, banks are chartered both by the Federal Government and by State governments, and most National banks are free, if they choose to do so, to shift to a State charter and drop their membership in the Federal Reserve System; and all State member banks can withdraw from Federal Reserve membership at will. While we believe the advantages of membership in the Federal Reserve System are substantial, if the non-interest bearing reserves which the member banks are required to maintain are too large in relation to the comparable requirements on State banks, then there is a strong incentive for banks to withdraw from the System, and the effectiveness of the Federal Reserve as a monetary authority is undermined.

I have testified before committees of the Congress that, in my judgment, the present levels of reserve requirements of member banks are higher than they need to be for purposes of sound monetary management, and have indicated that as developments provide occasion for reductions, such reduction would be appropriate and consistent with the financing of needed economic growth. This is, of course, a matter of judgment, but I can assure you that my judgment is based on what I sincerely believe to be the best interests of the country, not on any undue concern for the banks.

In summary, it is our sincere judgment that an amendment to the legislation which is now before you, which would require "that the Federal Reserve System, while pursuing its primary mission of administering a sound monetary policy....should bring about needed monetary expansion by purchasing United States Government securities.... rather than by further lowering of bank reserve requirements," would be undesirable on both technical and substantive grounds.

One other aspect of the proposal by Congressman Reuss deserves special comment. The language of his amendment provides that the purchases of Government securities should be of varying maturities. As we understand it from his statement, this language is intended to require that the Federal Open Market Committee revise its present policy with respect to the maturities in which purchases and sales for the open market account are normally conducted.

Congressman Reuss referred to this aspect of his proposal, ~~which is not included in Con. Res. 196~~, only in passing. He stated, however, that his proposed amendment as a whole would involve "no backtracking on the Treasury-Federal Reserve Account of 1951, no commitments to peg the U. S. security market at par, no support measures at a time when monetary expansion would be inflationary." His proposal, nevertheless, raises some very basic and fundamental questions with respect to the way in which Federal Reserve policy is effectuated and might have very far-reaching repercussions in the securities markets.

For a number of years the System has followed an operating procedure of confining open market operations in U. S. Government securities to the short-term sector of the market. This procedure was adopted after years of experience with other practices and after a careful study of their effects upon the operation of the market and upon the effectuation of appropriate monetary policies. It was adopted not as an immutable rule but as a working guide to current operations. It has been reaffirmed by the Committee each year.

Variations from the rule can be, and have been, adopted upon vote of the Open Market Committee whenever deemed appropriate for aiding Treasury financing or the effective operation of the Government securities market, or for purposes of monetary policy. In a sense then, a resolution of Congress that the System should take such actions when consistent with its primary objective is unnecessary.

The present working procedure was adopted because experience and study revealed that other practices interfered with the attainment of the System's primary objective, as well as with effective functioning of the market and with debt management.

Federal Reserve operations in Government securities influence price and yield of outstanding securities in three fundamentally different ways. (1) They change the volume of reserves available to member banks for making loans and investments or paying off debts, (2) they affect the volume of securities available for trading and

investment, and (3) they influence the expectations of market professionals and other investors regarding market trends. These effects are described and thoroughly analyzed in an article entitled "Open Market Operations in Long-Term Securities" published in the Federal Reserve Bulletin for November 1958.

Of these effects of System open market operations, the first is by far the more important. Under our percentage reserve system, additions to or subtractions from commercial bank reserves have a multiple expansive or contractive effect on bank lending and investing power. This means that any given change in System holdings of securities will be accompanied by a change in commercial bank portfolios of loans and investments several times as large. Thus, the major effect of System open market operations on market prices and interest rates will be the one that results from commercial bank transactions in securities to expand or contract their loan and investment portfolios.

The effect on market prices and interest rates as a result of an increase or decrease in Federal Reserve holdings of particular securities and a corresponding decrease or increase in their market supply will be relatively minor. In evaluating this latter effect, it needs to be kept in mind that the size of System open market operations is ordinarily small in relation to the volume of any category of securities outstanding in the market.

The third effect of Federal Reserve open market operations in long-term securities, namely, their potential effect on market professionals and portfolio managers, can be disruptive to the market. Long-term securities are normally subject to wider price fluctuations relative to given changes in interest rates than are short-term issues and, therefore, trading or portfolio positions in them incur the greater price risk. Furthermore, the System holds the largest single portfolio of Government securities in the United States economy, and it is the only investor of virtually unlimited means. If the System conducts open market operations in longer term securities, professional investors and portfolio managers may either step to the sidelines or endeavor to operate on the same side of the market as they believe--perhaps from rumor--the System to be operating.

In the former case, the Federal Reserve would become in fact the price and yield administrator of the long-term Government securities market. In the latter event, the operations might encourage either artificially bullish or bearish expectations as to prices and yields on long-term securities, and lead to unsustainable price and yield levels that do not reflect basic supply and demand forces. Either of these effects would permeate and disturb the whole capital market. Consequently, instead of working as a stabilizing force for the economy, open market operations in long-term securities could have the opposite result.

After the Treasury-Federal Reserve accord, when the Federal Reserve for a period attempted to aid Treasury offerings of new issues that were closely priced relative to the market, Federal Reserve purchases of the supported securities were often in very large amounts. Those or other securities had to be sold in the market to prevent undue additions to the supply of reserves, and no useful purpose was served by the operation.

The function of the long-term capital markets is to transmute the money savings of the economy, as supplemented by bank credit, into real investment. Tendencies in security prices and yields in these markets are vital and sensitive indicators of the relative pressures of the supply of money savings and bank credit and the demand for funds to finance real investment. If the Federal Reserve were to intervene in the functioning of supply and demand in order directly to administer prices and yields on long-term securities or in a way that resulted in unsustainable prices and yields, it would impair the usefulness of an important guide to monetary policy.

An important objective of debt management policy is to tailor the structure of the debt so as to provide investment for, and to attract, various types of funds. Long-term securities are designed to attract savings; short-term securities draw in liquid balances. Variations in the structure of interest rates reflect differences in supply and demand forces in the different sectors of the money and capital markets and perform an important allocative function in influencing the flow of funds from one to another.

To the extent that Federal Reserve operations attempt to influence these variations in interest rates in accordance with some arbitrary judgment, they interfere with, rather than aid, market adjustments that are necessary to bring about an appropriate allocation of funds to meet existing demands.

Federal Reserve operations in different sectors of the market for the purpose of influencing interest rates in one sector rather than in another are likely to have but little influence in aiding Treasury debt management or affecting the relationship between long-term and short-term rates. Because of the high degree of fluidity as between various maturity sectors of the market, fluctuations of any magnitude in one sector are transmitted with considerable promptness to other sectors.

If the System should attempt, for example, to bolster long-term interest rates by purchases of bonds and to offset the effect on reserves by accompanying sales of short-term securities, long-term yields would tend to decline and short-term yields to increase. There would then be a tendency for market participants to shift from long-term securities to short ones. The consequence would either be an adjustment of yields back to previous relationships or the necessity for continued purchases and sales by the System. This process could continue until the System's portfolio was composed predominantly of long-term securities, thus hampering its ability to operate flexibly to meet temporary variations in reserve needs.

Another effect of a policy of endeavoring to maintain long-term yields, without affecting reserves, by buying long-term bonds and selling short securities, would be to increase greatly the over-all liquidity of the economy. Not only would the supply of short-term securities in the market be increased, but also all bonds outstanding would be made more liquid because they can be more readily converted into cash as a result of Federal Reserve open market operations.

It continues to be my judgment that, in order to avoid interfering unduly with the structure of rates as determined by basic market factors, it is essential that System operations be conducted in short-term securities, where the price impact of purchases and sales is at a minimum. Also, to be prepared for operations to absorb reserves the System must hold a substantial portfolio of short-term securities. If the System should attempt to cover needs for long-term growth through purchases of securities of varying maturities, additions would probably not exceed half a billion dollars in a whole year to cover the growth in required reserves of member banks, plus some additional amount to cover whatever growth there might be in currency. Allowance would need to be made for gold movements. These needs are small relative to the total of System operations and to the volume of securities in the market. Moreover, they vary considerably from time to time and are not easily measurable at any given time, because of rather wide variations in the economy's needs for cash.

Variations in cash needs result from changes in the economic climate, from shifts in holdings of non-cash liquid assets, and from other factors which influence views as to cash demands. It is these variations that call for careful analysis of current economic developments and for flexibility and the exercise of a high degree of judgment in determining current monetary policies.

Compliance with the Employment Act, the achievement of maximum sustainable growth, the maintenance of reasonable stability in the purchasing power of our money, and the necessity of keeping our debt service charges to a minimum. The monetary officials should discharge their responsibilities in a manner consistent with these objectives to ^{the} a maximum degree that is feasible.