

William McChesney Martin, Jr., Papers

Box 24/Folder 7

145

Series V, Subseries C

Hearings, 1957

Burgess

9 2
12
108

9 2
12
184
92
1104

ANSWER TO SENATOR KERR'S QUESTION

I. Beginning in January 1953 and thereafter,

- (a) State the policy directives adopted by Federal Open Market Committee. Indicate whether each marked a change in previous monetary policy and the direction of the change.

The policy directives adopted by the Federal Open Market Committee and the reasons for their adoption are set forth in Record of Policy Actions of the Federal Open Market Committee prepared annually by the Board of Governors of the Federal Reserve System, in accordance with the requirements of the Federal Reserve Act, and published in the Annual Reports of the Board of Governors. Copies of these reports for the years 1953-1956 are submitted herewith. The record for 1957 will not be available until next year.

The records of Open Market Committee actions may be found in the Annual Reports on the following pages:

1953 Annual Report	Pages 86-105
1954 Annual Report	Pages 92-98
1955 Annual Report	Pages 89-111
1956 Annual Report	Pages 17-47

Attached are summaries of the principal Federal Reserve policy actions from the beginning of 1953 to the end of 1956, with brief explanations of the purposes of such actions. These summaries have been prepared by the Board of Governors of the Federal Reserve System and previously published by the Joint Economic Committee of Congress or by the Board of Governors.

WT:lim
7/26/57

USE OF FEDERAL RESERVE INSTRUMENTS
January 1953 - December 1956

Date	Action	Purpose of action	
		Intent with respect to effect on credit and money	Explanation
January 1953	Raised discount rates from 1-3/4 to 2 per cent and buying rates on 90-day bankers' acceptances from 1-7/8 to 2-1/8 per cent.	Restrictive	To bring discount rates as well as buying rates on acceptances into closer alignment with open market money rates and to provide an additional deterrent to member bank borrowing from the Reserve Banks.
February 1953	Reduced margin requirements on loans for purchasing or carrying listed securities from 75 to 50 per cent of market value of securities.	None	To reduce margin requirements from the high level imposed early in 1951, in the judgment that the lower requirement would be adequate to prevent excessive use of credit for purchasing and carrying stocks.
May-June 1953	Purchased in open market about \$900 million U.S. Government securities.	Relief of credit market tensions.	To provide banks with reserves and to permit a reduction of member bank borrowing from the Reserve Banks at a time when such borrowing was high, credit and capital markets were showing strain, and seasonal needs for funds were imminent.
July 1953	Reduced reserve requirements on net demand deposits by 2 percentage points at central Reserve city banks and by 1 percentage point at Reserve city and country banks, thus freeing an estimated 1.2 billion of reserves.	Expansive	To free additional bank reserves for meeting expected seasonal and growth credit demands, including Treasury financing needs, and to further reduce the pressure on member bank reserve positions.

USE OF FEDERAL RESERVE INSTRUMENTS
January 1953 - December 1956

Date	Action	Purpose of action	
		Intent with respect to effect on credit and money	Explanation
July-December 1953	Made net purchases in open market of U. S. Government securities totaling \$1.7 billion.	Expansive	To provide banks with reserves to meet seasonal and growth needs and to offset a continuing gold outflow with little or no additional recourse to borrowing. This action and the one below were taken in pursuance of a policy of active ease adopted in view of the business downturn.
January-June 1954	Limited net sales to about \$900 million of U. S. Government securities in open market.	Expansive	To absorb only part of the reserves made available by the seasonal deposit contraction and return flow of currency thereby further easing bank reserve positions.
February 1954	Reduced discount rates from 2 to 1-3/4 per cent and buying rates on 90-day bankers' acceptances from 2-1/8 to 1-3/4 per cent.	Expansive	To bring discount rates as well as buying rates on bankers' acceptances into closer alignment with market rates of interest and to eliminate any undue deterrent to bank borrowing from the Reserve banks for making temporary reserve adjustments.
April-May 1954	Reduced discount rates from 1-3/4 to 1-1/2 per cent and buying rates on 90-day bankers' acceptances from 1-3/4 to 1-1/2 per cent.		
June-August 1954	Reduced reserve requirements on net demand deposits by 2 percentage points at central Reserve city banks and by 1 percentage point at Reserve city and country banks, and	Expansive	To supply the banking system with reserves to meet expected growth and seasonal demands for credit and money, including Treasury financing needs.

USE OF FEDERAL RESERVE INSTRUMENTS
January 1953 - December 1956

Date	Action	Purpose of action	
		Intent with respect to effect on credit and money	Explanation
June-August 1954 (continued)	requirements on time deposits by 1 percentage point at all member banks, thus freeing about \$1.5 billion of reserves in the period June 16-Aug. 1. Sold or redeemed U. S. Government securities totaling about \$1 billion in July and August.	Cushioning	Reductions in reserve requirements were offset in part by temporary sales of securities in order to prevent excess reserves from increasing unduly at the time, but security purchases were resumed as need for funds developed.
Sept.-November 1954	Made net purchases in open market of approximately \$850 million.	Expansive	To supply the banking system with reserves to meet expected growth and seasonal demands for credit and money.

FEDERAL RESERVE POLICY ACTIONS DECEMBER 1954-DECEMBER 1956

Date	Action	Purpose of action
December 1954	Made net purchases of U. S. Government securities in open market of less than \$50 million, all under repurchase agreements with dealers and brokers. Member bank borrowing increased to an average of \$250 million in December.	To meet part of the temporary end-of-year needs of banks for reserve funds, but in view of rising credit demands, to permit these needs to be reflected in part in slightly less easy reserve positions.

FEDERAL RESERVE POLICY ACTIONS DECEMBER 1954-DECEMBER 1956

Date	Action	Purpose of action
January-June 1955	Sold in the open market or re-deemed U. S. Government securities totaling \$1.3 billion. Member bank borrowing increased to an average of more than \$400 million in the second quarter.	To offset effects of seasonal factors affecting bank reserve positions and, in view of strong credit demands, to bring about somewhat greater member bank borrowing from Federal Reserve Banks.
January 1955	Raised margin requirements on loans for purchasing or carrying listed securities from 50 to 60 per cent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities in a period of increasing use of credit for carrying securities.
April 1955	Raised margin requirements on loans for purchasing or carrying listed securities from 60 to 70 per cent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities in a period of increasing use of credit for carrying securities.
April 1955	Raised discount rates from 1-1/2 to 1-3/4 per cent.	To bring discount rates into closer alinement with open market money rates and make borrowing by individual banks more expensive.
March-December 1955	Made net purchase of bankers' acceptances in open market totaling \$28 million.	To recognize increased use of bankers' acceptances by business as a means of financing international trade.
July-December 1955	Made outright purchases of Treasury bills in the open market totaling \$700 million net and increased repurchase agreements with dealers and brokers by 300 million. Member bank borrowing increased to an average of about \$850 million in September and more than \$1.0 billion in November but declined to about \$850 million in Dec.	To meet part of reserve needs associated with seasonal factors, thus requiring banking system to meet needs in part by further increasing indebtedness. This action was taken with a view to providing for seasonal needs while limiting undue expansion of bank credit.
November-December 1955	Purchased when-issued Treasury certificates of indebtedness totalling \$167 million.	To facilitate Treasury refunding in period of money market stringency. Supply of reserve was consistent with overall open market policy at time.

FEDERAL RESERVE POLICY ACTIONS DECEMBER 1954-DECEMBER 1956

Date	Action	Purpose of action
August-Sept. 1955	Increased discount rates from 1-3/4 to 2-1/2 per cent. This increase was made in two steps at all reserve banks except Cleveland.	To keep discount rates in an appropriate relationship with market rates of interest and thus maintain a deterrent on excessive borrowing by individual banks at the reserve banks.
November 1955	Increased discount rates from 2-1/4 to 2-1/2 per cent.	
January 1956	Reduced System holdings of U. S. Government securities by over \$1.4 billion through sales in the market, redemption of maturing bills, and termination of repurchase agreements. Member bank borrowings increased to weekly averages of \$900 million in late January.	To offset seasonal return flow of currency and reduction in reserve needs and restore degree of restraint prevailing before December action to moderate restraint temporarily
February and March 1956	Bought small amounts of Gov't securities at times. Member bank borrowings declined somewhat in February but increased substantially in March as result of sharp increase in required reserves.	To meet changing reserve needs and avoid an increasing degree of credit restraint in view of growing tone of uncertainty as to economic prospects.
April and May 1956	Discount rates raised from 2-1/2 per cent to 2-3/4 per cent at 10 Reserve Banks and to 3 per cent at 2 Banks around middle of April; System holdings of U. S. Gov't securities reduced by \$350 million. Member bank borrowings at Reserve Banks rose to over \$1 billion.	To increase restraint on credit expansion, in view of sharp increase in bank credit in March and indications of broad increase in spending, growing demands for credit, and upward pressures on prices and costs.
Late May-early August 1956	Increased System holdings of U.S.Gov't securities around end of May and end of June and maintained holdings at higher level than in previous period.	To meet currency needs around holidays, to cover added demands for reserves around tax payment and midyear settlement periods, and to avoid increasing the degree of restraint in view of uncertainties in economic situation.

FEDERAL RESERVE POLICY ACTIONS DECEMBER 1954-DECEMBER 1956

Date	Action	Purpose of action
August-November 1956	Discount rates raised late in August to 3 per cent at the 10 Reserve Banks with rates of 2-3/4 per cent. System holdings of U.S.Gov't securities increased by nearly \$1 billion; member bank borrowings at Reserve Banks rose to average of \$900 million in August and averaged between \$700 and \$800 million in other months.	Discount rates increased in conformity with rise in market rates resulting from vigorous credit demands. Policies designed to increase and maintain restraint on undue credit expansion while covering seasonal and other temporary variations in reserve needs, including effects of frequent Treasury financing operations.
December 1956	System holdings of U.S.Gov't securities and bankers' acceptances increased by over \$550 million, including substantial repurchase agreements with dealers. Member bank borrowings declined to weekly averages of around \$600 million, except in last week of year, and at times were less than excess reserves.	To supply reserve funds in recognition of additional pressures in money, credit, and capital markets resulting from seasonal factors and international conditions, at a time when lower liquidity ratios of banks were themselves exerting restraint on bank lending.

Sources: Flanders Subcommittee Hearings on Monetary Policy, December 6 and 7, 1954, pp. 14-15. Joint Committee Hearings on the President's Economic Report, January-February 1956, p. 258. Forty-third Annual Report of the Board of Governors of the Federal Reserve System, p. 16.

ANSWER TO SENATOR KERR'S QUESTION

- I. (b) Describe each Treasury financing action, other than the regular weekly bill offerings, but including regular weekly bill offerings where the Treasury increased the amount in order to raise additional cash
- (2) Identify those Treasury financing actions which in your judgment were supported by the Federal Reserve either through (1) open market operations, or, (2) reductions in reserve requirements.

The basic principle governing Federal Reserve actions during Treasury financing operations is set forth in the continuing operating authorities or statements of operating policy adopted in the annual meeting of the Federal Open Market Committee in March 1956:

"Operations for the System account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee."

The Federal Reserve System in its open market operations generally has followed a policy of maintaining stable conditions in the money market during periods of refunding and of taking into account additional needs for reserve funds when the Treasury comes to the market for cash.

The only deviation from the above directions occurred on November 30, 1955, when the Federal Open Market Committee authorized

the purchase of up to \$400 million of 2-5/8 per cent December 1, 1956, certificates of indebtedness on a when-issued basis. This action was taken in response to a request made by the Secretary of the Treasury for assistance directed toward preventing undue cash redemption of the maturing issue and with cognizance of the possibility of psychological deterioration of the whole securities market if the Treasury offering came to be regarded as a failure. Total purchases made under this authority amounted to \$167 million.

Reserve requirements were reduced in the summers of 1953 and 1954 and in both cases the reductions were designed to supply reserves for seasonal demands including Treasury financing needs. In each year these were large cash offerings of Treasury securities which required temporary increases in commercial bank deposits and required reserves.

WT:lim
7/26/57

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 24, 1957

To Chairman Martin

Subject: _____

From Arthur W. Marget

At the Hearings of the Senate Finance Committee on July 9, 1957, the following exchange took place between Senator Malone, as questioner, and Secretary Humphrey:

"Q. How much capital, American capital, is invested in foreign nations now? Do you have any way of knowing?

"A. No, I do not know. There are large amounts, of course."

One never knows, of course, what line the questioning may take; and I have no thought that one should be prepared on every conceivable matter of fact. Since, however, Senator Malone did raise this particular factual question, I thought you might be interested in the appended table, which was prepared by Mr. Allan F. Rau, of our Division, under the direction of Mr. Furth.

Aum

Attachment

International Investment Position of the United States

in Selected Years, 1914-56

(Billions of dollars)

	1914	1919	1930	1939	1946	1956 ^{e/}
<u>U. S. investments abroad</u>	3.5	7.0	17.2	11.4	18.7	49.4
Private	3.5	7.0	17.2	11.4	13.5	32.9
Long-term	3.5	6.5	15.2	10.8	12.3	30.0
Direct	2.6	3.9	8.0	7.0	7.2	21.8
Portfolio	.9	2.6	7.2	3.8	5.1	8.2
Short-term	n.a.	.5	2.0	.6	1.3	2.9
U. S. Government ^{1/}	0	0	0	0	5.2	16.5
Long-term	0	0	0	0	5.0	15.3
Short-term	0	0	0	0	.2	1.2
<u>Foreign investments in U. S.</u>	7.2	4.0	8.4	9.6	15.9	32.0
Long-term	6.7	3.2	5.7	6.3	7.0	13.7
Direct	1.3	.9	1.4	2.0	2.5	4.7
Portfolio	5.4	2.3	4.3	4.3	4.5	9.0
Short term assets ^{2/}	.5	.8	2.7	3.3	8.9	18.3
<u>U. S. net creditor position</u> (excluding U. S. Government investment abroad)	-3.7	3.0	8.8	1.8	-2.4	.9
Net long-term	-3.2	3.3	9.5	4.5	5.3	16.3
Net short-term	-.5	-.3	-.7	-2.7	-7.6	-15.4

Notes:

^{1/} Excludes World War I loans.

^{2/} Includes U. S. Government obligations in 1946 and 1956.

^{e/} Estimate

Data for 1914 refer to June 30, for the other years to December 31.

Data for various years are not wholly comparable because of different sources and methods. Because of rounding, figures do not always add to totals.

SOURCE: Data for 1914-46 are from U. S. Department of Commerce, Survey of Current Business, August 1956. Data for 1956 are estimated on the basis of the balance-of-payments figures for 1956, Survey of Current Business, June 1957, except for the re-investment of foreign earnings, which are assumed to have been unchanged from 1955, and adjustments for changes in security values estimated by Federal Reserve.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 29, 1957

To Chairman Martin

Subject: Underwriting Activities of

From Arthur W. Marget

Foreign Central Banks

The appended memorandum, by Messrs. Katz and Wood, was prepared in response to a suggestion, by Governor Balderston, that question might be raised with respect to the responsibilities of central banks as underwriters of Government debt operations.

We intend to keep this matter under study.

AWM

Attachment

- Fed Reserve Board -
- Treasury -
- Budget -
- C. E. Adkinson -

DRAFT:SIK:RCW:dcl
July 29, 1957

To: Mr. Marget

Subject: Underwriting Activities
of Foreign Central Banks

From: Samuel I. Katz and Ralph C. Wood

In accordance with your inquiry, we have surveyed the central banking legislation and charters in 23 countries to obtain information on the underwriting activities of these central banks. The preliminary results of this survey are consolidated in this memorandum. For the purposes of this survey, underwriting is defined as the responsibility or practice of the central bank to take over all or any residual part of Treasury security offerings.

1. ~~Some~~ ^{Two} countries are explicitly permitted under their basic charters to engage in underwriting:

Australia

New Zealand

2. One country provides a limited amount of central bank credit to a separate institution which underwrites new government issues:

Belgium

3. ~~Some~~ ^{Six} ~~five~~ countries are specifically prohibited from underwriting in the governing legislation:

Ceylon
Philippines

Austria
France
Greece
Switzerland

4. The remaining 14 countries which have no specific reference to underwriting activities in the basic charter or legislation can be classified into the following sub-groups according to their practice:

a. Those which customarily take over entire Treasury offerings:

Indonesia
Taiwan
Korea

To: Mr. Marget

- 2 -

b. Those which customarily take over only residual amounts of new offerings:

Sweden
Denmark
Norway

India
Pakistan
Japan

Italy

c. Those which customarily follow the practice of not taking over new Treasury offerings but may on occasion make limited purchases:

United Kingdom
Canada

Netherlands
Germany

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

SPECIAL

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 31, 1957

To Chairman Martin

Subject: Bank of France and Underwriting

From Arthur W. Marget

of Treasury Operations

I note that, at the end of your memorandum of July 30, 1957, on "Techniques of Debt Management," you refer to the French situation in connection with this general proposition: "Certainly the fact that some foreign central banks underwrite their Treasuries is no reason for us to copy them." In the Katz-Wood memorandum of July 29 entitled "Underwriting Activities of Foreign Central Banks," on the other hand, France is listed as one of six countries which "are specifically prohibited from underwriting in the governing legislation."

Clearly, any apparent conflict between the two must derive from a difference in the definition of "underwriting." In the Katz-Wood memorandum, "underwriting is defined as the responsibility or practice of the central bank to take over all or any residual part of Treasury security offerings." I have asked Mr. Wood to spell out the French arrangements in more detail. His memorandum on this point is attached hereto.

AWM

Attachment

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 31, 1957

To Mr. Marget

Subject: Bank of France Underwriting

From R. C. Wood

of French Treasury Issues

This memorandum is in response to your request for an elaboration of the reasons for classifying France as a country in which the central bank is prohibited from underwriting new security offerings by the French Treasury.

It may be useful to note at once that in the case of France the distinction between the underwriting of the Treasury, on the one hand, and of new Treasury issues, on the other, is of great importance for the answer one gives as to whether an underwriting function is performed by the central bank. In the past the Bank of France has supported Treasury operations in a great variety of ways, and still does so in several. One method is that of special advances by the Bank to the Treasury, under "conventions" between the two; characteristically, in the past, the amounts involved under particular conventions have been initially set in relation to the size of the Treasury's problem at the time, frequently being raised later as the Treasury's problem intensified. However great the efforts the Treasury may have made to minimize its residual deficits--and it is only fair to point out that while the advances to the Treasury have often been substantial, this facility has seldom, except in time of war, been used as an open-end financing device--"conventions" of this kind would appear to approximate an underwriting relationship, as contrasted with a comparatively permanent Treasury facility at the central bank, fixed well in advance of expected use, such as the one which the United States Treasury has with the System.

Moreover, if the question were whether the Bank of France has an obligation to underwrite the Treasury in the market, as late as one month ago one would have had to say that while in practice the Treasury never abused the possibility, as a matter of law the Bank of France was required to discount any and all Treasury paper with no more than three months to maturity offered by the market. Now that this requirement has been abolished, the Bank of France nominally has full discretion as to the buying support it will give the Treasury in the market.

It may also be relevant to note that the institutional arrangements in France are such that the Treasury is strongly supported, if not actually underwritten, by the financial resources of several large governmental and quasi-governmental institutions. This fact presumably tends to moderate the pressure for underwriting

To: Mr. Marget

- 2 -

by the central bank, at times when the Treasury would otherwise be under extremely severe strain. In this respect, however, the difference between France and some other countries, such as the United States, is only one of degree.

On the specific question of central-bank underwriting of new Treasury issues, the view that the Bank of France is prohibited from such underwriting is based on the following facts and reasoning.

1. Article 106 of the codification of statutes of the Bank of France, the law of December 31, 1936, specifies that the operations of the bank which are "generative of note issue" are (1) gold operations, (2) discount operations, (3) advances on public bills and on stock securities, and (4) permanent advances to the national government. ^{1/} Article 107 specifies that the bank can in no case "and under no pretext" perform or undertake operations other than those permitted it by law and by its statutes.

2. A decree-law of June 17, 1938, reads in part as follows:

With a view to acting on the volume of credit and normalizing the money market, the Bank of France is authorized---in addition to the operations enumerated in Article 106 of the codification decree of December 31, 1936---to buy, on the free market, within limits and on conditions established by the General Council of the Bank of France, negotiable short-term public bills and private bills eligible for discount, and to sell such bills without endorsement. These operations may in no case be carried out for the benefit of the public Treasury or other issuing public agency.

3. The basic law is therefore that the Bank of France can buy short-term public bills only in the market. I have assumed that if it appeared necessary to pass a special law specifying that (in addition to the operations listed in (1) above) the Bank of France might buy short-term public paper in the market, it should have appeared equally or even more necessary to stipulate that the Bank

^{1/} The permanent advances are a fixed amount, now amounting to 50 billion francs, of consolidated advances going back in part to 1857. The special advances referred to above have been made under the authority of specific conventions approved by law, and subsumed in the 1936 codification under a section listing "special or transitory provisions."

To: Mr. Marget

- 3 -

might buy long-term public paper, had it been the intention of Parliament to empower the Bank to buy such paper; I have therefore concluded that the Bank has formal power to buy public short-term paper only, and only in the market. ("Short term" is not defined in the relevant French statutes, but probably includes two-year paper and possibly even longer maturities; some European countries regard paper of up to five years' maturity as short term.) The legal position on long-term paper is not clear; but one of the officials at the French Embassy states that whatever the legal position may be, the Bank of France does not in fact buy long-term public paper.

4. That the decree-law of 1938 is still in force is confirmed by the language of the convention of June 26, 1957, under which the Bank of France will on August 15 buy, directly from the Treasury, 50 billion francs' worth of Treasury certificates maturing November 15 next. This convention (which, as usual, has been approved by Parliament and by the President of the Republic, thus giving it the force of law) specifically indicates that it is in derogation of the decree-law of 1938. This language is standard in these conventions.

5. The fact that there have been rather frequent derogations from the 1938 law does not appear to change the essential character of the basic law, which is that direct purchases by the Bank from the Treasury are prohibited. Any derogations from the basic law require Parliamentary approval.

Raw

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 9, 1957

To Chairman Martin

Subject: _____

From Arthur W. Marget

In the Hearings before the Senate Finance Committee on August 6, 1957, there was the following exchange between Senator Martin and Mr. Burgess:

- Q. "Mr. Burgess, what are your reasons for not agreeing with the contention that higher interest rates are a cause of inflation? . . .
- A. ". . . I know something about the economic literature . . . and I may say that I have not been able to find anywhere a support in one of the economists for the belief that interest rates in themselves are a cause of inflation."

It is always dangerous to say that one cannot find support for a given proposition -- no matter how foolish -- "in one of the economists." Actually, the proposition that higher interest rates have an inflationary rather than a deflationary effect is more than 100 years old: the proposition was advanced particularly by Thomas Tooke in one of the great monetary controversies of the 19th Century.

I cannot imagine that you would be interested in pursuing this matter of what "the economic literature" has had to say on this subject; but if, by any chance, you would be interested, you will find the matter discussed in my Theory of Prices, Volume I, pages 247-258.

awm

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 13, 1957

To Chairman Martin

Subject: Leith-Ross on Credit Control

From Arthur W. Marget

The recent pamphlet by Sir Frederick W. Leith-Ross on "Orthodox Credit Control in Post-War Conditions" not only has been the subject of comment in the press, but also was mentioned in the following colloquy between Senator Kerr and Mr. Burgess on July 31:

"Q. Would you say the widespread adoption of monetary policies since 1950 has helped to achieve greater economic stability in the countries which adopted them?

"A. I would say very emphatically, yes.

"Kerr then cited a report of the International Institute of Banking Studies which said that flexible monetary policies had been disappointing."

Obviously, these matters can hardly be settled by simple reference to "authority." But, as Mr. Furth shows in the appended memorandum, it happens, in this particular case, that Senator Kerr, and most of the press commentators, have simply misrepresented the substance of Leith-Ross's remarks, as well as the substance of the reports by members of the International Institute of Banking Studies on which Leith-Ross's own remarks are supposed to have been based. This is clear from the excerpts appended to Mr. Furth's memorandum.

Aum

Attachments

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 13, 1957.

To Mr. Marget

Subject: Leith-Ross on Credit Control.

From J. H. Furth JHF

Sir Frederick W. Leith-Ross has just published a pamphlet on "Orthodox Credit Control in Post-War Conditions" (International Institute of Banking Studies, Rotterdam, 1957), which has received some attention in the press.

The press reports gave the impression that Sir Frederick had found monetary policy ineffective; however, these reports are based on a misunderstanding of Sir Frederick's statements.

Sir Frederick deals primarily with credit control based exclusively on variations in bank rate; apparently he believes that all other tools of monetary policies are not "Orthodox". On the basis of his own observations and of reports by the members of the International Institute of Banking Studies from other European countries, Sir Frederick comes to the conclusion that variations in bank rate have lost some of their previous effectiveness, primarily because of three reasons: (1) the prevalence of exchange controls prevents variations in the bank rate from influencing decisively the international flow of capital; (2) the prevalence of self-financing of industrial corporations makes industry less dependent upon bank credit; (3) the increased volume of Government transactions, reflected both in a high level of taxation and a high level of public expenditures, increases the importance of fiscal policy and debt management in relation to variations in the bank rate.

In spite of these developments, Sir Frederick concedes that variations in the bank rate still have proved effective, in the United Kingdom, partly for reasons of "psychology" but in part also because the increase in bank rate diverted funds from bank deposits into Treasury Bills and thereby reinforced the tight money policy of the Bank of England. He also concedes that reports from Austria, Germany, and (surprisingly enough) Norway indicated the effectiveness of variations in bank rate in these countries.

More important however, is Sir Frederick's statement that most countries supplemented variations in bank rate by other tools of monetary policy, and that monetary policy thus defined has proved very effective. This was true particularly in Austria, Germany, Italy, and Sweden and in part also in Belgium, Denmark, and the Netherlands. This list virtually exhausts the number of European countries in which monetary policies were used as an important part of the stabilization efforts of the authorities.

To: Mr. Marget

-2-

August 13, 1957

Sir Frederick reports that increases in bank rates had little effect on savings, except in Austria and Italy. On the other hand he is able to report that there has been no conflict between a well-understood policy of high employment and a policy of tight money; on the contrary in the face of inflationary pressures, tight money policies have been necessary to keep the economies on a high-employment level.

Sir Frederick points out that monetary policy should always be accompanied by other appropriate policies, including in particular tools of fiscal policy and debt management. His only recommendation in the field of monetary policy aims at bringing financial institutions other than commercial banks under the influence of the central bank.

This book is protected by copyright and has been removed.

Author(s): Leith-Ross, Sir Frederick W.
Title: Orthodox Credit Control in Post-War Conditions
Date: 1957
Publisher: Institut international d'etudes bancaires
Place of
Publication: Rotterdam
Page Numbers: 13-15; 21; 24-26; 29; 39; 47-49;

Wm. G. Sawyer

Assumed question re purchasing power adequate to support consumption to absorb product of our plants and maintain employment.

To gain perspective, one must remember that for many years now, consumers have been demanding services (as distinct from gadgets) in increasing amount. The slanting of demand toward services is reflected both in the spending stream and in the employment figures.

Now as applied to the immediate past, our firms have been seeking to expand plant capacity faster than we save. Saving, of course, represents what we do not spend for goods and services. Consequently, total demand exceeds resources and prices rise. If new money or new credit were pumped in, prices would rise still faster, because real production to take care of new construction as well as consumption would remain ^{relatively} unchanged.

It is not the task, nor is it within the power, of the Federal Reserve to supply new savings for investment in housing or in business plant and equipment, or for the financing of the construction of schools and roads. Savings for these purposes can only come out of current income that is not spent for consumption, because only through such saving are physical resources of men and materials released for investment.

Federal Reserve policies, even if properly attuned to the cash holding desires of the public, cannot always assure continued growth and stability. The maintenance of equilibrium requires the delicate balancing of an intricate structure of consumption and investment involving a great multitude of goods and services. No

master mind can direct with assurance the smooth functioning of this complex mechanism. The forces of the market and the price system must be relied upon to direct and attract the flows of money and of goods and of services into appropriate channels and to keep them moving. There are bound to be obstructions and hindrances and slowdowns from time to time.

Confirming the growing demand for services are certain data in the
1957 Economic Report to the President:

	<u>1946</u>	<u>1956</u>
p. 114		
Per cent enrolled in school or college	42.3	52.3
p. 114		
Bachelor's and first professional degrees conferred	136,174	325,000
p. 109		
Number of weeks of vacations (millions)	34.4	70.0

August 19, 1957

There are four lines of inquiry pursued by Senator Long in his questioning on which I would like to comment:

Assertion I--The American economy today is not characterized by a shortage of manpower.

Assertion II--The American economy today is not confronted with a shortage of physical capacity to produce.

Assertion III--Consumer disposable income, at its present purchasing power, has not grown during the past year.

Assertion IV--More production is the best cure for inflation.

I would like to take up these four questions separately and point to the pitfalls.

1. It is true that the percentage of unemployment today is higher than in 1951, 1952, and 1953, but this does not mean that the current rate of employment is not pressing on our manpower resources. As I said in my statement, "Despite the existence in some lines of reduced employment and slack demand, many employers have rising costs when they seek to expand activity by adding appreciably to the number employed. Often the manpower required has to be bid away from other employers." In other words, under current conditions of very high employment, further efforts to stimulate output on the scale suggested would soon spark a further rise in costs which would accelerate the inflation spiral. I am appending a technical appraisal of the unemployment figures cited in the hearings. It throws considerable light on the problem.

II. My statement pointed out that specific bottlenecks in capacity that impeded growth in production a year ago have been largely relieved and that individual bottlenecks are no longer the cause of bidding up of

prices of individual commodities because of limited availability. This does not mean, however, that materially higher utilization of current plant capacity would not entail rising costs. The extent of the upward pressure would vary from one line to another depending upon the technical efficiency of the reserve capacity, as well as many other considerations. The direction would be toward higher costs and higher prices everywhere.

III. The assertion that consumer disposable income has not increased during the past year disregards the inflation which is our problem, by stating it in terms of ex-inflation dollars. Consumer personal income available for spending has grown appreciably both in absolute amount and on a per capita basis during the past year. It is the largest single component, by far, of the total spending stream that has sustained the continued rise in both in wholesale prices and the cost of living. If consumers had saved a larger proportion of this income, it would have been available for the financing of schools, highways, and capital plant without contributing further to inflation and the reduction in the value of their spending dollars. As it is, the inflation that has actually occurred has offset in large part the buying power of the increase in consumer disposable income.

This sort of development is not exceptional during a period of inflation. For example, practically all of the gains in real weekly earnings in manufacturing industries since World War I have come in periods of price stability. From mid-1946 to mid-1948, a period of sharp inflation, both consumer

prices and average weekly earnings rose by close to 25% and there was little gain in real wages. From mid-1948 to mid-1950, however, there was little change in prices, but a gain in the purchasing power of weekly earnings of about 10%. From mid-1950 to the spring of 1952 sharply rising prices again offset rising weekly earnings. During the ensuing long period of stability in the cost of living, lasting until early 1956, the rise in money earnings was reflected in comparably large gains in real wages. Since that time further large wage increases have been largely nullified by the inflation. Thus during the whole period since the war, the appearance of inflation has coincided with a leveling off of real wages.

IV. Increased production per se does not cure inflation. Money income is generated in the process of production and becomes part of the spending stream. As was pointed out on Tuesday, one man's expense is another man's income. Consequently, increases in production in themselves add to the flow of spending as well as to the flow of goods. Increased output to the full extent permitted by our capabilities is good, provided, of course, that it is the right production and is financed in such a way as to promote continued prosperity. However, if there is excess money demand present in the economy at a time when resources are actively employed that excess will cause a rise in prices. Increased production under these circumstances will add to the spending stream as well as to the stream of goods and services. It will not, therefore, eliminate the excessive money demand

that is the cause of rising prices. For inflation to be curbed, excess money demand must be absorbed from the spending stream. This may come about by the development of a budget surplus, by increased planned savings, by curtailed borrowing from banks or by a slowing down in the growth of the money supply or in its turnover. It does not result automatically from increased production.

No one would maintain that a cessation of production--the reverse of this proposition--would stop a deflation. Likewise, an increase in production does not in and of itself stop an inflation. The unhappy condition of France today is a standing example of this fact. It sharply increased its production as well as its productivity but it failed to take measures adequate to reduce the excess money demand that was necessary to avert a crisis.

Attachment--"Factors Accounting for Differences in Unemployment; 1951 - mid-53 and 1957" (prepared by Murray Wernick)