Minutes for April 14, 1960

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin
Gov. Szymczak
Gov. Mills
Gov. Robertson
Gov. Balderston
Gov. Shepardson
Gov. King
Minutes of the Board of Governors of the Federal Reserve System

on Thursday, April 14, 1960. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. King

Mr. Sherman, Secretary
Miss Carmichael, Assistant Secretary
Mr. Thomas, Adviser to the Board
Mr. Young, Adviser to the Board
Mr. Shay, Legislative Counsel
Mr. Molony, Assistant to the Board
Mr. Fauver, Assistant to the Board
Mr. Hackley, General Counsel
Mr. Noyes, Director, Division of Research and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Koch, Adviser, Division of Research and Statistics
Mr. Brill, Associate Adviser, Division of Research and Statistics
Mr. Hostrup, Assistant Director, Division of Examinations
Miss Hart, Assistant Counsel

Items circulated to the Board. The following items, which had been circulated to the Board and copies of which are attached to these minutes under the respective item numbers indicated, were **approved unanimously**:

Letter to the Federal Reserve Bank of Minneapolis authorizing the furnishing of copies of examination reports of certain banks to Montana Shares, Incorporated, Havre, Montana.

Item No. 1
Letter to the Bureau of the Budget recommending that a proposed statute amending the Negotiable Instruments Law to eliminate the necessity of protests with respect to domestic drafts and checks be submitted through the Council of State Governments for consideration by State legislatures.

Mr. Hostrup then withdrew from the meeting.

Letter to group of 21 Senators in reply to their letter of March 12, 1960 (Item No. 3). Chairman Martin reported that the Treasury Department had suggested several additional changes in the letter to 21 Senators regarding credit and monetary operations, as approved at the Board meeting on April 13. These changes had been incorporated in a copy of the letter which was distributed prior to the meeting. After a brief discussion, several changes were agreed upon and the letter as revised at this meeting was approved unanimously, with the understanding that the changes would be discussed with the Treasury Department before the letter was typed in final form. Later in the meeting Mr. Noyes reported that Mr. Young had talked with Mr. Baird, Under Secretary for Monetary Affairs, and Mr. Mayo, Assistant to the Secretary, who were in agreement with the additional changes. A copy of the letter sent to the Senators is attached as Item No. 3, together with a list of the addressees who had signed the letter of March 12 to Chairman Martin.
During the foregoing discussion Mrs. Ulrey, Economist, Capital Markets Section, Division of Research and Statistics, entered the room, and at its conclusion Messrs. Young and Noyes withdrew.

Loans to finance executive stock options under Regulation U (Item No. 4). Following receipt of a number of proposals for the Board to amend Regulation U in order to accord preferential treatment to loans for the purpose of exercising restricted stock options, the staff of the Legal Division was asked to review the arguments for and against such an amendment. A number of corporate resolutions or other requests for such an amendment had been forwarded to the Board through Federal Reserve Banks, and in some cases individual Reserve Bank directors had indicated an active interest in the matter. While formal requests for a change in the Regulation had come from only a few Federal Reserve districts, informal inquiries had also been received from several additional Reserve Banks, and letters had been received from time to time through Congressional sources. The results of the staff study were set forth in a memorandum dated March 16, 1960, from the Legal Division, copies of which had been distributed before this meeting along with a memorandum dated March 11, 1960, from the Division of Research and Statistics.

The study was concerned with restricted stock options granted to executives and key employees in conformity with the rules in section 421 of the Internal Revenue Code of 1954. That section of the Code
specifies rules for determining whether an employee realizes ordinary income or capital gains when he resells stock which his corporate employer has allowed him to purchase at a bargain. The memorandum noted that the Board had on several occasions in the past considered and rejected proposals for granting especially favorable treatment to loans for the purpose of exercising restricted stock options, since such transactions were made subject to the Regulation by an amendment that became effective in 1945. Since 1950, option plans have been used more generally than in earlier years, and according to the memorandum from the Division of Research and Statistics, the market value of optioned stock is highly concentrated among officers and key employees of a relatively small number of companies.

The Legal Division memorandum presented the following specific alternative possibilities for amending Regulation U in order to provide preferential treatment to loans connected with stock options: (1) granting loan value equal to 90 per cent of the option price; (2) making an exception for loans to exercise option rights similar to the exception for exercise of subscription rights; (3) adopting a provision to exempt loans for stock purchases not made through brokers or dealers; (4) adopting a flexible provision with a loan value lower than the prevailing loan value applicable to other margin purchases, but fluctuating with it.

According to the Legal Division memorandum, there were practical difficulties connected with adoption of each of these proposals, apart
from the policy question involved. The policy considerations which would seem to be within the scope of Board responsibility included a judgment as to whether extensions of credit which would result from a more favorable provision would be "excessive"; the effect on the quality of bank credit if banks have felt obliged to make loans on an unsecured basis; and the desirability of granting exceptional treatment to a special group if that grant is likely to lead to further requests for exceptional treatment under circumstances which exhibit varying degrees of similarity.

At Chairman Martin's request, Miss Hart outlined the results of the study completed by the Legal Division. She noted that in view of the significant value of a stock involved in stock options, it was usually necessary for executives to secure loans to purchase such stock. When margin requirements were high, as at the present time, there was likely to be pressure to amend Regulation U in order to grant preferential treatment to loans for the purpose of exercising such options. When margin requirements were low, she observed, there was not as much pressure in this direction.

Miss Hart noted that for about 10 years after its adoption in 1936, the original section 2(e) of Regulation U had the effect of exempting bank loans made in connection with the exercise of the relatively few stock options granted during that period. In 1945, this section was
removed from the Regulation and loans for the purpose of exercising stock options have received no special treatment since that time. She indicated that the chief new factor now in the picture was the large volume of credit that might be involved in making loans to the holders of stock options.

Mr. Brill stated that the basic statistics on the potential amount of stock option credit were rather sparse. However, available information revealed that, if the potential stock options were exercised, the volume of customer credit outstanding would no doubt rise substantially.

Governor Mills said that in his view the passage of time has justified the Board's position that the restricted stock option is a device to grant compensation and is recognized as such by the Internal Revenue Code, but it is to be sharply distinguished from credit transactions because the credit transactions that would be involved in a relaxation of the regulation were purely and simply to grant option holders a preferential advantage over other investors. This had been the Board's repeated position in earlier discussions of proposals to accord stock options preferential treatment, but over and beyond that the entire practice had been increasingly suspect in the eyes of the general public. One economic reason was that the practice would encourage corporations to expand their resources on the basis of debt rather than on equity at the behest of option holders in that the equity
obtaining through these options would result in greater leverage. Option holders, he observed, have a completely selfish interest in stock options and, accordingly, they were unfair to the general body of stockholders since such options have the effect of diluting the equity of the stockholders.

Chairman Martin said that this presented very well the basic considerations that were involved in this question. He could not see that there was any particular reason now for changing the position that the Board had taken in recent years, and no member of the Board indicated a different view.

After further discussion, it was agreed that the Board would reaffirm its previous position that no change should be made in Regulation U with respect to preferential treatment to loans for the purpose of exercising stock options. It was understood that the Federal Reserve Banks would be advised to this effect, and that appropriate letters would be sent in response to pending requests for the Board to consider amending Regulation U with respect to loans involving stock options. A copy of the letter sent to the Federal Reserve Banks on April 27, 1960, is attached as Item No. 4.

Messrs. Solomon, Hexter, and Brill and Miss Hart and Mrs. Ulrey withdrew from the meeting at this point.

Department store sales program (Item No. 5). At a joint meeting of the Board and the Presidents of the Federal Reserve Banks on March 22, 1960,
Mr. Irons, Chairman of the Presidents' Conference Committee on Research and Statistics, made a number of recommendations in connection with the department store statistics program. Pursuant to discussion at a Board meeting on March 28, 1960, Mr. Irons was requested to submit a detailed statement covering his proposals, and such a statement was included in a letter from him dated March 30, 1960, copies of which had been distributed. Among his recommendations was one to establish a committee to work out a department store statistics program that would be acceptable to all parties involved. Also distributed prior to the meeting were (1) a memorandum dated April 13, 1960, from the Division of Research and Statistics giving a brief description and evaluation of the various department store series compiled by the Federal Reserve System, and (2) a memorandum regarding a luncheon meeting on April 6 attended by representatives of the Federal Reserve Bank of New York and New York City department store executives.

Chairman Martin said that he was continuing to receive letters and telephone calls regarding the department store statistics and what the Federal Reserve planned to do about the program, concerning which representatives of the trade had met with the Board on March 7, 1960. The Federal Reserve had had a long history in this field, he said, and it was apparent that an important public relations problem was involved. It was clear that the stores and others regarded this as a valuable service. In his view, the cost of the service was not the major problem.
It was important, however, that the data be prepared on a sound basis, and he emphasized the desirability of discontinuing as quickly as possible the publication of any unreliable department store statistics. He expressed agreement with the suggestion contained in Mr. Irons' letter for appointment of a joint committee to study the problem and he outlined his views as to how the Board should be represented on such a committee.

Following a discussion of the possible membership of a committee such as had been suggested by the Presidents' Conference, during which Mr. Noyes re-entered the room, it was agreed that steps should be taken to form a small committee along the lines proposed, such committee to have as its purpose the re-examination of the department store statistics program. The committee would consist of representatives from the Federal Reserve selected from high level staff persons, from the department store trade, and from the Bureau of the Budget or the Bureau of the Census.

It was also agreed that Mr. Sherman be appointed as the Board representative on the committee, with the understanding that he could draw on the staff for technical advice.

A discussion followed as to the procedure for implementing the proposal of the Conference of Presidents, as modified and approved by the Board at this meeting. In this connection it was suggested that the matter should first be discussed with Mr. Irons as Chairman of the Committee on Research and Statistics of the Conference of Presidents, and that if he concurred, it should then be taken up with Mr. Alfred C. Thompson, President of the National Retail Merchants Association, who had written to the Board on February 17, 1960, as a result of which
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the delegation of department store representatives met with the Board on March 7. There was concurrence with a suggestion made by Chairman Martin during the discussion that the department stores should probably have more than one representative on the proposed committee and that, if they so desired, they might have as many as the number from the Federal Reserve and Budget-Census combined.

Mr. Molony inquired as to the type of announcement by which interested parties might be informed of the purpose of the proposed joint committee. For example, should there be an indication, as suggested in the March 30 letter from Mr. Irons, that the System is committed to a policy of terminating the collection and distribution of department store data as soon as arrangements can be effected to transfer the responsibility to the Bureau of the Census?

Governor Balderston responded that the Board had not taken such a position.

Chairman Martin also commented that the Board was not taking such position, adding that he did not think it would be desirable for the Board to pass on this question now when, in his judgment, that was not the matter of greatest importance.

Governor Balderston said that he had the feeling that the negotiations with the department store representatives at this stage required great care. Failure to consult with the department store representatives at earlier stages had, in his opinion, resulted in...
some of the misunderstandings that had developed. Governor Balderston's view was that at the outset it would be desirable for Mr. Thompson as President of the National Retail Merchants Association to visit the Board's offices for the purpose of discussing procedure, not for the purpose of discussing any substantive questions. From such a meeting, it could be determined whether Mr. Thompson believed that the procedure for having a committee look into the substantive questions was practicable and whether he was prepared to appoint representatives from the trade to such a committee. In Governor Balderston's opinion, the Federal Reserve had much at stake in the way of relations and friendships built up with the department stores over the years. The System wanted to accomplish something in the way of improved quality of statistics and it would like to save some money although he doubted that the latter would result. In his opinion, if Mr. Thompson believed that the approach discussed by the Board this morning was workable, the substantive questions could then be taken up by the committee which could proceed with some assurance that at the end of the negotiations months hence the department stores would agree to whatever solutions were arrived at as a result of the committee's work.

Chairman Martin said that this seemed to him to be the right approach and that unless there was objection Mr. Thompson would be asked to come to Washington for the purpose of discussing the subject. There
being no indication of disagreement, it was understood that the procedure suggested by Governor Balderston would be followed.

Secretary's Note: Governor Balderston discussed the proposed procedure with Mr. Irons as Chairman of the Presidents' Conference Committee on Research and Statistics on April 15, who expressed concurrence with the approach, and arrangements were then made with Mr. Thompson, President of the National Retail Merchants Association, for him and Mr. Flanel, General Manager of the Controllers' Congress of the Association, to come to Washington on Tuesday, May 10, 1960, to discuss the matter. A copy of a letter sent to Mr. Irons on April 15, 1960, regarding the proposed procedure is attached to these minutes as Item No. 5.

Messrs. Thomas and Koch withdrew during the foregoing discussion.

Hearing on H. R. 8516. Mr. Shay reported receipt of advice that a hearing probably would be held in about a month on H. R. 8516, a bill to provide for the retirement of Federal Reserve Bank stock and for other purposes. This bill was introduced on August 4, 1959, by Congressman Patman and it was expected that the hearing would be held by Subcommittee 3 of the House Banking and Currency Committee of which he is Chairman.

The meeting then adjourned.

Secretary's Note: Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson today
approved on behalf of the Board the following actions affecting the Board's staff:

**Appointment**

Ray M. Reeder as Operator, Tabulating Equipment, Division of Administrative Services, on a Trainee basis, with basic annual salary at the rate of $3,255, effective the date he assumes his duties.

**Salary increase**

Thomas G. Young, Assistant Federal Reserve Examiner, Division of Examinations, from $4,790 to $4,980 per annum, effective April 17, 1960.

[Signature]

Secretary
Mr. H. G. McConnell, Vice President
and Secretary,
Federal Reserve Bank of Minneapolis,
Minneapolis 2, Minnesota.

Dear Mr. McConnell:

This refers to your letter of March 16, 1960, with which there was transmitted a copy of a letter dated March 14, 1960, addressed to you from Montana Shares, Incorporated, Havre, Montana, having reference to furnishing that corporation copies of reports of examination made by your Bank of First State Bank of Chinook, Chinook, Montana, Citizens Bank of Montana, Havre, Montana, and Liberty County Bank, Chester, Montana. Also enclosed was a copy of a resolution adopted by the board of directors of each of the aforementioned banks, authorizing your Bank to furnish copies of such reports of examination as Montana Shares requested.

Montana Shares does not own or control a majority of the shares of any one of the three aforementioned banks. However, the confidential section of reports of examination of each of those banks shows that each bank's board of directors has authorized Montana Shares to perform certain services for it; Montana Shares receives service fees from each of the banks; and the board of directors of each bank is willing to have reports of examination furnished to Montana Shares.

In the circumstances, the furnishing of copies of the reports of the examinations made in February 1960 and of future reports of examination of each of those banks to Montana Shares is approved pursuant to paragraph 8, section 9, of the Federal Reserve Act and applicable provisions of the Board's Rules of Organization, provided that it is understood by representatives of Montana Shares that information obtained from examination reports of each of the three aforementioned banks is subject to the same restrictions and conditions as to recall, use, disclosure, or publication, as those which govern the copies of reports furnished to State member banks pursuant to Form F.R. 410-45-Receipt.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.
Mr. William D. Carey,
Executive Assistant Director,
Executive Office of the President,
Bureau of the Budget,
Washington 25, D. C.

Dear Mr. Carey:

This is in response to your communication of March 21, 1960, inquiring whether the Board has any proposals for State legislation which it would desire to present through the Bureau of the Budget for consideration by the Committee of State Officials on Suggested State Legislation of the Council of State Governments.

On June 17, 1959, the Board in its letter to the Bureau of the Budget stated that the Executive Council of the American Bankers Association had approved a recommendation made by the Association's Committee on State Legislation for enactment by the States of a proposed uniform statute amending the Negotiable Instruments Law to eliminate the necessity of protests with respect to domestic drafts and checks. It was then understood that the ABA Committee had transmitted copies of the proposed statute to the various State Bankers Associations urging that they sponsor its enactment.

The proposed statute was drafted in collaboration with a Committee of the Conference of Presidents of the Federal Reserve Banks, and the Board in its letter expressed the opinion that enactment of the statute by the various States would be desirable. However, it is assumed that the proposal was not submitted in time for inclusion in the "Suggested State Legislation" program for 1960.

In view of the above, the Board recommends that the proposed uniform statute be submitted through the facilities of the Council of State Governments for consideration by the State legislatures in their 1961 sessions. As requested by you, four copies of the proposed statute and accompanying statement are enclosed.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

Enclosures
The Honorable Senator,
United States Senate, Washington 25, D. C.

Dear Senator:

Let me thank you again for the interest in monetary affairs shown by you in the letter of March 12 which you signed with other Senators. It is important to have public understanding of our monetary problems and of the reasoning that underlies decisions in this field. The very fact that there are no easy answers to the problem of maintaining a sound money makes even more important thoughtful study and discussion of the subject.

On the basis of your letter, it would appear that we can readily agree that monetary policy should exert a counter-cyclical force, combating inflation and deflation alike so as to contribute to a healthy, growing economy, aided by stability in the purchasing power of the dollar, that will provide a high level of dependable jobs. That agreement over the methods of attaining these objectives is more difficult to achieve than agreement over the objectives themselves is only natural, since highly technical matters are involved.

The portion of your letter concerning the desirability of preventing harmful speculation and undesirable practices in the Government securities market illustrates the point. The fact that neither the Treasury nor the Federal Reserve has as yet felt ready to recommend legislation directed to that end is not ascribable to a reluctance to make detailed legislative proposals if we are confident that such are needed. Our studies of the problem have shown, however, that some very real, practical difficulties would be faced in drafting such legislation. The studies have also indicated that future speculative excesses may be adequately limited without new legislation.

I am sure that we all agree that it is important to maintain a strong and efficiently functioning market for Government securities. To both the Treasury and Federal Reserve, this is a matter of primary importance. By and large, we have such a market today. In this country, indeed, we are accustomed to a broad, resilient market through which: (a) large amounts of funds can be transferred expeditiously and at low cost among financial and nonfinancial institutions; (b) the Treasury can float substantial cash offerings of securities without formal underwriting; and (c) the Federal Reserve can provide or withdraw bank reserves.
as needed. In striving to correct market imperfections or deficiencies, care is needed to avoid injuring the market's capacity to bring buyers and sellers together in transactions involving both very large and relatively small amounts of investable funds.

When legislation to regulate the securities industry was being formulated in the early 1930's the Congress determined that the interests of the Government and the economy in general called for the exemption of both U. S. Government securities and those of State and local governments, and the Congress excluded them from the legislation as enacted. One of the difficult questions raised by proposals to regulate trading in and margin on U. S. Government securities is whether such regulation could and should also include State and local issues.

If you have had an opportunity to examine the quite voluminous study of the Government securities market by the Treasury and the Federal Reserve System, copies of which were provided to the members of the Joint Economic Committee and to the Chairmen of the Committees on Banking and Currency, Ways and Means, and Finance, in July 1959, I am sure you will share the view that this is a very complex subject, with a highly technical background.

As the Congress recognized in the 1930's, the Government securities market differs from the stock market in many important respects. Stock brokers carry margin accounts for their customers, thus extending credit directly to them. The vast bulk of margin transactions in stocks is handled in this way. In contrast, most of the transactions in the Government securities market are handled by dealers who, unlike brokers, take positions in securities, and absorb the market risk growing out of any fluctuations in their value. Borrowing for purchasing or carrying of Government securities by these dealers is arranged through a wide variety of channels, bank and nonbank. The transaction between the dealer and his customer is a cash transaction. For this reason, the regulation of U. S. Government security dealers or their practices would not have any effect on the margins on which securities are carried by their customers, who must arrange the financing from other sources.

An important use of credit in this market is by dealers to finance the holdings of Government securities which constitute their "stock in trade." Dealer borrowing is both protected and limited by their capital as well as by any specific margin lenders may impose on dealers' borrowings. I am sure that we are all mindful that any significant additional limitation on the availability of financing to dealers would necessarily reduce dealer participation in Treasury financings, to the disadvantage of the Government. It should also be mentioned that a large share of dealer financing relates to the carrying by dealers of very short-term Treasury bills, where the period to maturity is so short that the risk of loss attributable to market fluctuations is negligible.
As we further assess the problems of preventing undue speculation in Government securities, it has seemed to both the Treasury and the Federal Reserve System that substantial progress can be made toward desired objectives under existing authority. One approach that has been taken has been the issuance of a supervisory instruction to national bank examiners that prudent and sound bank lending practice calls for appropriate margins in the case of all loans to nondealer borrowers against Government securities as collateral. It is possible that an approach of this kind will not only influence the lending practices of banks but also, indirectly, those of nonbank corporations that advance funds on a temporary basis to the Government securities market through repurchase agreements and similar arrangements.

Leading banks and corporations have already been cautioned about the unfortunate consequences of under-margined credit such as occurred in the 1958 episode. It is our understanding that the Treasury will not hesitate to warn against any credit extensions which appear to contribute to excessive speculation if and when such excesses should threaten to recur. Our study of the market gives reason to believe that much of the unmargined credit extension in 1958 was an unwitting contribution to speculation and that the officers of banks and nonfinancial corporations so involved are eager to avoid any repetition.

In addition, the Treasury has already announced plans to modify its refinancing procedures to discourage the assumption of speculative positions in maturing issues. When appropriate, it will rely on issues for cash rather than on exchange offerings, thus making it feasible to require sizable downpayments as a bar to excessive speculation. Also, the absence of value on the "rights" of holders of maturing issues would avoid speculation in "rights," and curb speculation in the market at the time of refundings. This type of speculative activity was an important source of instability in the Government securities market in mid-1958.

Last year's study of the Government securities market revealed evidence of widespread satisfaction on the part of buyers and sellers with the mechanism of the market and the trading practices which prevail in it. We found little or no feeling that present mechanisms or practices are disadvantageous to the investing public to any significant degree, and we gathered a definite impression that existing transaction arrangements are efficient and economical. There was a commonly expressed need, however, for additional statistical information, available promptly to the public, about the flow of transactions through the market, and about the market's use of credit. The Treasury and the Federal Reserve System have now inaugurated such a program. From the standpoint of public interest, these comprehensive factual materials about the market should be helpful in future evaluations of its
performance, and in identifying what needs there may be for regulatory intervention.

It is our belief that this informational program will be an effective supplement to the steps mentioned above, all of which will help to reduce the future dangers of speculative excesses in the market. It is not possible to determine at this stage if such steps will be sufficient to avoid completely future speculative excesses. We will continue, therefore, to study the problem as to whether statutory regulation of the market is desirable, and, if so, what character it should take to be most effective.

The second item in your letter would have the System discontinue the practice of normally limiting its transactions in the United States Government securities market to the short-term sector. By this limitation, which has been, we believe inaccurately, referred to in some commentary as the "bills only" policy, the System limits the effect of its open market operations on the pattern of security yields and prices by maturities established by the free interplay of savings-investment processes in the market. From inception of this policy, the System has been aware of exposure to criticism by those who adhere to the viewpoint that the Government should exert more active, direct influence over the levels and structure of market interest rates. To take account of this viewpoint and make sure, in the light of developing experience and critical reappraisal, that its policy was effectively serving the public interest, the System has frequently reviewed this decision. The Open Market Committee is prepared to make, and in fact does make, adaptations in its operating procedure when it believes that economic or market conditions call for such action. For example, the Committee authorized such adaptations in November 1955 and July 1958, when the System acquired some longer term securities, in connection with Treasury financings; and in August 1959 and February 1960, when the System exchanged its maturing issues for other than short-term securities.

That the System has shown its readiness to make adaptations to unusual conditions does not alter the fact that the System needs normally to follow operating procedures which will have as little disturbing influence as possible on the functioning of the Government securities market. It follows that, if the System is to abandon its practice of normally conducting its open market operations in short-term securities, the alternative adopted should measure up to this criterion. On the basis of our experience, the Federal Open Market Committee does not believe that an alternative of continuing intervention in the long-term as well as short-term sectors of the market would result in a better functioning market from the standpoint of public interest and does believe that such a policy would make the market more unstable.
For these reasons the Federal Open Market Committee has continued the System's procedure of normally conducting its operations in short-term securities. However, if the suggestion that we abandon our present operating procedure is based on the assumption that our present policy is as rigid and inflexible as is sometimes attributed to us, I want to assure you that we have always been and continue to be prepared to alter these procedures whenever conditions may make it appropriate to do so.

On your third point, we are in substantial agreement. Our principal difference would seem to relate to the way in which changes in the turnover or velocity of money should be taken into account in arriving at a rate of growth in the quantity of bank credit and money that will be consistent with maximum economic growth and reasonable price stability. As I have testified to the Congress on various occasions, it is the Board's position that we should provide for such increases in the money supply as can be absorbed in a growing economy without generating inflationary pressures. Over the long run this may result in a rate of growth in the money supply which, as you suggest, might broadly match the long-term growth in real gross national product.

In your discussion, however, you suggest that the relationship between the money supply and gross national product over a period of a few years will tend to be quite close. Actually, short- and intermediate-term fluctuations in the ratio between these two aggregates, which is sometimes referred to as income velocity, appear to be fairly wide and to have a degree of independence from the pace of economic growth. These trends are related in part to variations in the public's attitudes toward the use of funds in general, and particularly to movements in the volume of other assets in the community which perform a short-term store of value function in competition with currency and demand deposits—often referred to as liquid assets, near monies, or money substitutes.

For this reason, we have found that it is important to consider not only the volume of money, narrowly defined; i.e., demand deposits adjusted and currency outside banks, but also the amount of time deposits at commercial banks and mutual savings banks, of shares in savings and loan associations, and of savings bonds and short-term Government securities in the hands of the public. If one includes the growth in these liquid assets in recent years, money and liquid assets expanded by an average rate of 4.2 per cent per year from 1953 to 1959. In my own judgment, the principal explanation of the slow rate of growth in the money supply over postwar years is that, during the war period, the public's holdings of money and of other liquid assets, especially U. S. Government securities, were built up to an abnormally high relative to gross national product, and, hence, in postwar years less expansion in money was needed while we returned to a more normal relationship between the money supply and gross national product.
The Honorable

The final point in the letter is an important but technical one. Its acceptance would require the System to determine in the present its choice as to the use of the instruments of monetary policy in future circumstances.

It is my personal view that, in absorbing the large volume of redundant reserves generated during the great depression in the 1930's and then supplemented by war finance, reserve requirements were pushed up to levels higher than are necessary or desirable in the long run, and higher than Congress intended they should be maintained indefinitely. It would be a mistake, however, to assume that it is our established policy to provide for all future increases in the money supply by reducing reserve requirements from the present average of around 16 per cent to some lower level, say 10 per cent.

I should like to point out that, in reply to a question from the Joint Economic Committee last fall, the Board stated unequivocally that "The Federal Reserve has had no policy specifically directed toward achieving a long-run secular decrease in reserve requirements." It follows from this statement that the Board accepts the use of the open market instrument as one way, and an important one, of providing the bank reserves needed to support long-term growth in the money supply. The System, in fact, has added to its holdings of United States Government securities regularly for this purpose in the decade since the Treasury-Federal Reserve accord. What the Board is not prepared to do is to commit itself and its successors not to use an instrument for monetary regulation that Congress devised and reaffirmed in the last session, when, all things considered, the use of that instrument would be the best way of making reserve funds more readily available to the banking system.

I might mention in this connection that legislation passed by the Congress in 1959 authorized certain changes in the structure of reserve requirements, including authority to count vault cash as reserves and the eventual elimination of the central reserve city classification. The equitable implementation of this legislation would appear to require some provision of the reserves needed for monetary growth through adjustments of reserve requirements.

To summarize, the Board's position on this point is that it would be improper for it to enter into any commitment which would limit the discretionary authority specifically granted to it by the Congress. We believe, and have testified, that it is desirable for the System to have authority to vary reserve requirements from time to time in either direction. We have also stated, however, that such authority is not indispensable to the effective day-to-day functioning of the System. If reserve requirements are to be maintained at present levels, or their...
The Honorable

use circumscribed, we believe that this should be accomplished by legislative action, not by a renunciation of authority by the Board.

In closing, I want to assure you of the Board's desire to cooperate with you at all times in furthering understanding of our policies, our reasons for them, and their relation to the economic condition of the United States.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.
List of Senators to whom Chairman Martin's letter of April 14, 1960, was sent

Paul H. Douglas
Clinton P. Anderson
Oren E. Long
William Proxmire
Eugene J. McCarthy
Pat McNamara
Wayne Morse
Jennings Randolph
E. L. Bartlett
Harrison A. Williams, Jr.
Joseph C. O'Mahoney
Frank E. Moss
Gale W. McGee
Edmund S. Muskie
Joseph S. Clark
Howard W. Cannon
Ernest Gruening
Hubert H. Humphrey
Frank Church
John A. Carroll
James E. Murray
Dear Sir:

From time to time requests have been received by the Board that Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Registered Stocks, be amended to provide more favorable treatment for loans for the purpose of exercising restricted stock options which conform to the applicable provisions of the Internal Revenue Code of 1954 than is provided for other loans for the purpose of purchasing or carrying stocks. Several such requests have been received in recent months, and the Board has reconsidered the entire question of such stock options and their treatment under the Regulation.

As on previous occasions when this matter has been considered, the Board believes that proposals for special treatment of loans for the purpose of exercising restricted stock options relate primarily to executive compensation rather than to credit regulation. In addition, it appears that a large potential volume of stock market credit would be involved in any proposal to accord such loans favored treatment. After re-examining the question in detail, the Board has again reached the conclusion that it would not be desirable to amend Regulation U to provide for special treatment of loans for the purpose of exercising restricted stock options.

Very truly yours,

Merritt Sherman,
Secretary.
Mr. W. H. Irons, Chairman,
Committee on Research and Statistics,
Conference of Presidents,
c/o Federal Reserve Bank of Dallas,
Dallas 2, Texas.

Dear Bob:

As indicated by Governor Balderston in his telephone conversation with you earlier this afternoon, the Board has considered the recommendations submitted in your letter of March 30, 1960, on behalf of the Presidents' Conference and its Committee on Research and Statistics, regarding department store statistics.

The Board agrees with the recommendation that a joint committee be formed to examine into this question. As your letter suggests, this committee would be expected to work out a program acceptable to all parties concerned. The composition of the committee that the Board has in mind would differ slightly from that suggested in your letter, in that the Board believes it should consist of one high-level staff representative from the Board, one from the Reserve Banks, one from the Bureau of the Budget or the Bureau of the Census, and three from the department store industry. The Board believes the department stores should be invited to appoint three in order to give them as many voices as the Federal Reserve and Budget-Census will have. The latter arrangement seems desirable also as a means of permitting expression from the different segments of the trade.

As Governor Balderston mentioned to you, the Board has designated me as its representative and it would look to the Conference of Presidents for designation of a high-level man (Vice President) from a Reserve Bank.

With respect to the recommendation presented under "A" in your March 30 letter, the Board believes that the objective of the committee should be to re-examine the existing department store statistical series with a view to determining what series are not sufficiently reliable to justify their collection and dissemination on the present basis, and generally to evaluate what series assist monetary and credit policy analysis and determination. It would also determine what additional data of a reliable nature now being collected are primarily for the use of the department stores and what data should appropriately be added or discontinued.
The Board does not believe that it is desirable to make any statement to the effect that the objective of the committee's work will be to terminate collection and distribution of department store data by the Federal Reserve System. All of those concerned are familiar with the general background of discussion to date. The fact that a joint committee is being formed to study the data would seem to be all that is necessary to assure that the committee's work goes forward on a constructive basis, without suggesting that the System had prejudged who ultimately will do the work of collecting and compiling such data as are needed by the stores, the System, and Government generally. The forty-year history of the present department store series makes the approach to the committee's work different from what it would be if a new statistical series were being undertaken.

The Board's suggestion is that the proposal for a committee as made in your letter and as modified by these suggestions be discussed with the President of the National Retail Merchants Association (presently Mr. Alfred C. Thompson of Miller & Rhoads, Richmond, Virginia) in the light of the March 7 meeting of the Board with representatives of that Association, which meeting was arranged at Mr. Thompson's request.

Subsequent to Governor Balderston's telephone conversation with you, this was discussed by telephone with Mr. Thompson and May 10 was tentatively set for his coming to Washington—the first mutually convenient date. The discussion with Mr. Thompson will be concerned with the procedural rather than with the substantive aspects of the problem, and assuming he concurs in the procedure outlined, the membership of the committee would be completed promptly.

A copy of this letter is being sent to Mr. Johns as Chairman of the Conference of Presidents.

Sincerely yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

cc: Mr. D. C. Johns