

December 2, 1954

To Mr. Spruill
From Robert V. Roosa *RM*
Copy to Messrs. Rouse and Roelse

Subject: Further Comments on the
Revised Second Draft of Chairman
Martin's Reply to Question 23
(from the Flanders Subcommittee)

My response to your request for something further on the Chairman's answer to question 3 can best be handled in a series of 3 memoranda, of which this is the first. This one will just comment on changes between the Chairman's draft of November 18, and his revised draft of November 26, and prepare the way for my next two memoranda. The second memorandum will be the direct response to your request for a short punchy rebuttal that could practicably be used within the short time likely to be available at the roundtable next Tuesday; with apologies, I found it much simpler to write this in the first person. The third will summarize the data bearing on whether or not the new procedures have improved the depth, breadth and resiliency of the market.

Mr. Rouse and I both want to stress again that we would feel it a violation of the most confidential side of our relations with the dealers to use any actual data obtained from them on positions or volume. We doubt that you should even refer publicly to the existence of these data, owing to the risk that this would only prompt some Congressman to ask for them. Consequently, the third memorandum is prepared essentially to reinforce your own convictions, so that you can "state with absolute confidence, or full assurance..." the more generalized conclusions suggested in the second memorandum. We hope, of course, that much of the third memorandum, and even more, can at some time become the basis for a calm and judicious review of the facts by System officials themselves on an entirely confidential basis.

The final version of the Chairman's reply on question 3 is even more effective than the edition of November 18. He has rearranged the sequence of

some of the text; he has dropped an occasional sentence that we might have been expected to pounce upon; and he has shaded various phrasings. Most notably, he has succeeded at last in reducing the frequency with which the words "depth, breadth and resiliency" are used. The major additions are elaborations of the technical market aspects of the Chairman's case. He adds only one major point of principle, but he improves all the rest of his case. The addition indicates that he, too, recognized his earlier failure to give some indication of the meaning of depth, breadth and resiliency. His vague references that might be interpreted to mean something on dealer positions, or on dealer volume, remain about the same, but he has added something on the nature of the pricing process in the market.

Having discovered alternatives to the term "depth, breadth and resiliency", in use of the words "continuity" and "responsiveness", he now goes on to define them. He indicates that "continuing markets" are those in "which dealers stand willing continuously to quote firm prices at which they will buy reasonably large quantities of securities from any or all sellers including each other". (p. 8). He later adds the further clarification that "continuity exists when variations in quotations as between successive transactions are minor". (p. 9). As for "responsiveness", this condition obtains when the "impact of sales in any particular sector, instead of being concentrated in that sector, is cushioned and dispersed in greater or less degree throughout all maturity sectors" (p. 9).

Consequently, if I were writing now the memorandum I sent to you on November 26, I would add a 10th major point, on which, if worded our way, there could be full agreement between the Chairman's position and our own.

That point would be that the continuity and responsiveness in the markets, as now defined by the Chairman (partly as substitutes for, but also as additions to, the "depth, breadth and resiliency" phrase) should be maximized through any techniques the System might use, in order to improve the capability of the Government securities market to contribute towards conditions favoring economic stability and growth. But the proviso would have to be added somewhere in there, as in so much of the rest of the Chairman's statement, that these things must be judged by what happens in the market place and not in the rarefied atmosphere of theoretical discussion conducted in another world. The further essential qualification should be that no techniques should be chosen, in the effort to achieve the ends of continuity and responsiveness, which would reduce the effectiveness of central banking itself, or keep it materially below its maximum potential for contributing to the growth and stability of the economy.

The second and third memoranda in this series will follow shortly.

RVR:emd