"P" file

September 17, 1954.

Mr. Oliver S. Powell,
c/o The Shoreham,
2500 Calvert Street, N.W.,
Washington 8, D. C.

Dear Oliver:

Answering your good letter of September 8, I would like to be able to say that developments during the recent past had contained the elements of a strong case for abandoning our "bills only" policy of open market operations. It would have been desirable, I believe, to have had the possibility open to us of operations in other sectors of the market, but it is difficult to assert that we could have made effective use of such authority.

There might have been, perhaps, an even chance that higher yields on government bonds would have brought more country bank reserves into use, but an increase sufficient to bring this about, particularly if the market thought we had engineered the increase as a matter of policy would have run the risk of adverse consequences. The maintenance of a high level of private and state and local financing of capital expenditures, including construction, is one of the present props of the economy which might be weakened if it were thought that we were trying to tighten up in that area.

If you go further back, however, I think it is fair to say that we might have avoided the rapid run-down of rates, which led to the recent situation if we had not confined our open market operations to Treasury bills. It should have been possible to maintain a policy of "active ease" without such a run-down of rates as we had, and therefore, to stay out of the box in which we recently found ourselves.

In my book, this business of central banking requires a little more complicated approach than just "putting in and taking out reserves" so as to maintain some figure or range of "free reserves". The cost of credit at short and long term is a central banking consideration as well as the supply of bank reserves.

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c/o The Shoreham,
Washington 8, D. C.

9/27/54

What I fear is that the longer we stay with the present policy, the harder it will be to work our way out, short of an inflationary situation in which direct action to affect the cost and availability of credit in all areas of the market would seem readily understandable to the market and to the public. That is why I argued so strongly that we should at least make our policy determinations only "until the next meeting" of the Committee, rather than set for an indefinite future period until changed by the Committee. We have lost or are losing the ability to go in lightly and exert moderate pressures to attain limited objectives. Action now, or in the future, is likely to be trumpeted about as a major move having a significance beyond our intentions or desires.

Nevertheless, I still believe we shall have to change our policy of operating only in Treasury bills. I do not want to revive the whole argument, however, until my approach can seem less negative and more positive, and until we have "cooled off" a little. This does not apply to what I consider to be our most foolish action, which was to say for the record that we enter into open market operations solely to supply or absorb reserves. At our next meeting I may suggest getting that off the books. So long as it is on the books, I think we can properly be charged with having a thoroughly narrow, mechanical and somewhat primitive view of central banking and monetary management.

With best regards.

Sincerely,

Allan Sproul.

AS:APP