June 1, 1961

To Chairman Martin

From Jerome W. Shay

Subject: Rouse testimony before Joint Economic Committee

This will confirm and amplify my report to you earlier today concerning the testimony of Mr. Rouse before the Joint Economic Committee this morning.

Members of the Committee present were Chairman Patman, Mrs. Griffiths, and Messrs. Sparkman, Reuss, and Pell (Democrats) and Messrs. Bush and Widnall (Republicans). Set forth below are significant or principal lines of questioning that developed during the morning. It seemed clear that there was no real plan or organization behind the questioning, which seemed to be pretty much on a random basis.

One of Mr. Patman's questions was whether there was any reason why the Government security dealers must all be located in New York (or Chicago). This was followed with the question as to why the Federal Reserve Banks could not act as dealers. Briefly, Mr. Rouse's reply to the first question was that New York is where the market is made, and his reply to the second question was that the Reserve Banks are customers and that, in any event, for the Reserve Banks to try to replace dealers would change the situation entirely.

Mr. Patman also asked concerning attendance at meetings of the Open Market Committee (i.e., who attended in addition to the 12 members of the Open Market Committee). His position, in effect, was that by having <u>all</u> presidents of Federal Reserve Banks present at FOMC meetings the law has been disregarded and the meetings have been "loaded" in favor of the "private" interests (representatives of commercial banks) as against the seven "public" members (members of the Board).

The next line of questioning pursued by Mr. Patman, in effect, was why open market operations and policy decisions could not be announced promptly, as is the case with changes in discount rates and reserve requirements. Mr. Rouse's answer to this was that to do so might create expectations in the market that would not in fact be borne out or which might possibly benefit speculators. Mr. Patman's position on this, however, was that the present system benefits the "sophisticated" people, who can rather easily determine what open market policy is even though there has been no public announcement of it and that this, of course, discriminates against the "little fellow".

Some of Mr. Patman's other questions were such as to suggest the possibility of "leaks" of open market information and the possibility of Federal Reserve personnel trading in the market on the basis of "inside" information. You will recognize this as a line of questioning which Mr. Patman frequently engages in and, as he has done in the past, he emphasized that there is no law or regulation against purchases of marketable securities by Federal Reserve or Open Market Committee personnel.

Pursuing a disclosure by Mr. Rouse that either he or one of his assistants took notes during Open Market Committee meetings, Mr. Patman, in effect, asked Mr. Rouse to supply these notes for 1960 to the Committee. Mr. Patman also indicated in this connection that he would ask you to supply Open Market Committee minutes for 1960 to the Committee. Mr. Rouse, in effect, said that he could not supply anything of this nature to the Committee without the consent of the Open Market Committee. There were indications by both Mr. Reuss and Senator Bush that undoubtedly the Open Market Committee would supply the Committee minutes upon a proper request. Mr. Patman made it plain, however, that he was not pushing Mr. Rouse, and it seemed abundantly clear that Mr. Rouse has nothing further to do in the matter at this time.

Senator Bush wanted to know whether the "nudging operation" undertaken in February had resulted in any easing of long-term interest rates. Mr. Rouse replied it had had some effect. In this connection, however, Mr. Rouse referred to your speech on April 11 at Boca Raton, Florida, and read therefrom the passages that, in effect, stated that the Federal Reserve was not seeking to set any particular levels of rate for either long or short-term securities and that the best guages of its operations were whether the outflow of funds to foreign centers was being stemmed and whether the flow of capital into productive investment activities was being facilitated. Mr. Rouse also emphasized that the basic purpose of the System was to affect the supply of bank reserves and that, while its operations had some effect on interest rates, this was not a primary objective for consideration.

Senator Bush was interested also in whether the System might encounter difficulty in disposing of any long-term bonds it might acquire. To this, Mr. Rouse replied that the market is a good market and that such bonds can be sold just as the long-term bonds acquired during the war had been sold.

Senator Sparkman's principal inquiry concerned the change in policy announced on February 20. In this connection, he referred to the Report of the Joint Economic Committee of May 2, 1961, on the Economic Report of the President, which rather clearly suggests that the System's transactions in the long end of the market had been inconsequential. Senator Sparkman's comments clearly indicated his belief that what the System had set out to do was to reduce long-term interest rates. Here, again, Mr. Rouse emphasized that the basic reasons for the System's operations was to affect bank reserves, and he referred again to your Boca Raton speech.

Mr. Widnall's only question was whether money could be expected to go into the short-term market if long-term rates were reduced. To this, Mr. Rouse replied affirmatively.

Mr. Reuss started his questioning by asking for definitions of short, intermediate and long-term securities. Mr. Rouse's response was that short-term included anything up to five-year maturities, that intermediate covered from five to 10-year maturities, and that anything over

10 years was a long-term security. This reply created some excitement, inasmuch as Mr. Reuss clearly expected Mr. Rouse to say that short-term securities were those with maturities not exceeding 15 months. Thereafter, there was some tracing of the history of the directives of the Open Market Committee from 1953 to the change in the directive on March 1, 1960, and also the change in the directive on October 25, 1960, and the purposes behind these changes. Mr. Reuss seemed to think that sometime during 1960 maturities of up to four years had been purchased, but Mr. Rouse said that nothing greater than 15 months had been acquired and that this had taken place subsequent to the October 25 change in the directive.

Mrs. Griffiths asked a series of questions with respect to technical aspects of Open Market Committee meetings and communications. These questions, for example, included whether the OMC minutes and the daily 11 o'clock market 'phone calls are stenographically transcribed. This line of questioning was such as to suggest that communications between the Committee and the Account Manager and the trading desk were too vague for adequate guidance and control of actual operations.

Another inquiry from Mrs. Griffiths was when during the last five years the System applied a policy of restraint and the exact economic factors that influenced the System in applying such policy. Mr. Rouse's reply was that he would try to supply this for the record, pointing out, however, that policy was a matter for the Committee, rather than the Manager of the Account.

Senator Pell's questions were such as to indicate agreement with Mr. Rouse that a stenographic transcript of minutes of the Open Market Committee would not be of real help in day-to-day operations and that the minutes as presently prepared might be more conductive to helpful discussion at Committee meetings and, in the end, serve as better guide lines to the manager and the desk.

JWS:ac
cc: Each Board Member
Messrs. Thomas, Young, Knipe, Molony, Fauver, Alderfer, Sherman, and Noyes