FEDERAL RESERVE BANK OF KANSAS CITY

KANSAS CITY 6, MISSOURI

November 13, 1961

Mr. Ralph A. Young, Secretary
Federal Open Market Committee
Board of Governors of the Federal Reserve System
Washington 25, D. C.

Dear Mr. Young:

This letter is with reference to your communication of September 12, 1961, transmitting proposed drafts of "Standing Rules Governing Open-Market Practice"—Attachment I, "Federal Open-Market Committee's Continuing Authority Directive to the Federal Reserve Bank of New York"—Attachment II, and "Current Economic Directive"—Attachment III.

In formulating our views as to the appropriate content of these operating procedure rules and the directive, we also have reviewed the replies of Presidents Ellis, Hayes, Fulton, Wayne, Allen, and Irons. Their recommendations adopted a broader, less limited approach to the formulation of the operating procedure rules than is contained in Attachment I. This broader approach we favor very strongly. At present, the need for such an approach appears most clearly on the ground that international considerations now and for the foreseeable future dictate it. Our reasons for favoring a flexible approach are not confined to the balance of payments problem, however, but rather reflect our conception of the role and scope of monetary policy for the domestic economy as well.

While a draft of operating procedure rules modifying Attachment I might be worded in various ways, the draft included in Mr. Hayes' statement of November 3, 1961, accords quite well with our views with two exceptions. In paragraph 3, we favor the inclusion of a phrase, somewhat along the line suggested by Mr. Irons, that would change the first sentence as follows: "Open-market operations are not for the purpose of fixing or pegging the price of any issue of Government securities, although such operations influence rates." In addition, we assume that the intended meaning of item (c) in paragraph 4 would be more correctly reflected in some such wording as "issues available in the market comparable in maturity to the new securities offered" instead of "comparable issues available in the market."

We also agree with the following suggestions with respect to Attachment I: (1) the modification of the statement on disorderly market conditions so as to remove any fixed commitment as to the specific action to be taken; (2) the inclusion of the word "generally" in the second sentence of paragraph 4 dealing with open-market operations during Treasury financings; (3) the deletion of the swaps paragraph (paragraph 5) from the standing rules; and (4) the deletion of items 7 and 8 from the standing rules and their inclusion elsewhere.

The contents of Attachment II defining the continuing authority directive to the New York Bank are acceptable in the revised form, with the exceptions already noted. It is preferable to confine the specific details of how operations shall be conducted to this directive rather than to include them in the standing rules of the Committee.

As to the form and content of Attachment III—the Current Economic Directive—several considerations are involved. Some of the ambiguity in past directives probably arose from a lack of agreement among the Committee members, and efforts to be completely explicit may make it more difficult to arrive at a consensus. But a lack of specific directions shifts the responsibility of interpretation to the Trading Desk and may subject the Desk to criticism which it should not bear. Attempts to be specific also are hampered by the fact that individual members of the Committee differ in the measures through which they express their choices—using free reserves, interest rates, credit expansion, and other terms that cannot be interchanged.

Despite these difficulties, the Committee should strive to develop methods of expressing their objectives in as unequivocal a form as possible. More progress toward this end would be made if further directives followed the general pattern of Alternative D in Attachment III. The type of detail that could be incorporated in the subordinate directive would have to be learned by experimentation over time and indeed might vary from time to time according to the circumstances prevailing. By reason of the unforeseeable developments that repeatedly occur, the details of the subordinate directive would need to be viewed as targets for the manager to pursue rather than as inflexible goals.

Sincerely yours,

George H. Clay
President