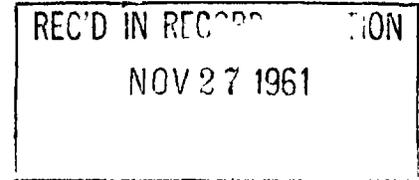




BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON



November 24, 1961

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Sherman

There is enclosed a copy of a letter from Mr. Bopp dated November 22, 1961, containing comments on the operating procedures, the directive, and continuing instructions of the Federal Open Market Committee, prepared pursuant to the suggestion made by Chairman Martin at the meeting on September 12.

A handwritten signature in cursive script, reading "Merritt Sherman". The signature is written in black ink and has a long, sweeping tail that extends to the right.

Merritt Sherman, Assistant Secretary,
Federal Open Market Committee.

Enclosure

FEDERAL RESERVE BANK
OF
PHILADELPHIA
(ZONE I)

REC'D IN RECORDS SECTION
FEB 13 1962

OFFICE OF THE
PRESIDENT

November 22, 1961

Mr. Ralph A. Young
Adviser to the Board
Board of Governors of the
Federal Reserve System
Washington 25, D. C.

Dear Mr. Young:

I have not responded earlier to the suggestion advanced by Chairman Martin during the meeting of the Federal Open Market Committee of September 12, 1961, because I have had no new ideas to offer. This reply to Mr. Sherman's telegram of November 16 reflects appreciation of the advantages that may result from a tabulation of current views of those who are or who are likely to be members of the Federal Open Market Committee.

Before expressing judgment on the issues immediately at stake, I should like to endorse with enthusiasm the decision to commission competent, uninvolved observers to review critically what we have done. I am persuaded that this innovation has very great promise for a viable Federal Reserve System. Of course, I disagree here and there with the Knipe and Broida memoranda; of course, they annoy me on occasion; but such disagreements and annoyances are relatively unimportant. What is important as we enter the future is a willingness to take the risks involved in authorizing and circulating among ourselves such memoranda. There are no experts in this field and we can profit immeasurably from uninhibited internal criticism.

My views with respect to the three attachments are as follows:

(1) Standing Rules

I am persuaded by the arguments that have been advanced to eliminate the Standing Rules. It seems to me undesirable to build any "boxes" that might inhibit the Committee from doing whatever it considers appropriate at any meeting because of fear that it might violate a "commitment" to the market.

On the other hand, if most members of the Committee feel strongly that standing rules are necessary, I would feel that the

FOR FILES
Ralph A. Young

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rules should be used for internal purposes and not published. One disadvantage of published rules is that any departure would require a public announcement. Another is that the Committee might refrain from deviating from the rules in cases when it would be desirable but not urgent to do so.

If the Committee wishes to retain the standing rules, whether published or not, I would in general favor wording as broad as possible to accomplish the purpose at hand. As examples, I would stress the broader objective of open market operations rather than supplying and absorbing reserves; prefer to emphasize a wide latitude of operations in all maturities and then make the qualification that most transactions ordinarily would be in short terms; incline to have the Committee retain a free hand to engage in swaps and a free use of repurchase arrangements.

(2) The Directive

The record of policy actions, in addition to meeting the statutory requirements, affords the best opportunity for informing the public about the Committee's policies and the conduct of open market operations. The record of each meeting should give a clear, concise analysis of business and financial developments considered in reaching a policy decision. In case of significant differences of opinion as to policy, the differing views should be explained briefly.

Instead of a "directive" to the Manager of the Account, I suggest that the record give a concise statement of the consensus agreed upon at each meeting. The consensus should include a brief appraisal of the economic situation together with the Committee's intention as to policy for the interval before the next meeting, similar to alternative (c) under Attachment III. Using alternative (c) as an illustration, the consensus might be stated as follows: "In view of the fact that there is still substantial unemployment and under-utilization of resources, it was the consensus of the Committee that open market operations should be directed toward maintaining about the same degree of ease." To meet the requirement of a recorded vote and to afford an opportunity for recording dissenting views, a vote could be taken on policy as stated in the consensus.

This method of handling the consensus and the recorded vote would avoid the danger of leaving the reader of the Annual Report with the impression that such a brief published directive covers the Committee's instructions to the Manager of the Account. The discussions and the minutes of the meetings serve as a much better "directive" than one or two sentences which necessarily must be in very general terms.

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The suggestion that the record of policy actions be prepared and sent to members of the Committee for their consideration and suggestions as promptly as possible after each meeting is a good one. As a means of keeping the public as well informed as feasible, I also favor publishing the record of policy actions quarterly with a lag of one quarter instead of annually.

(3) Continuing Instructions

If the standing rules and the directive were to be eliminated, a certain number of technical matters would remain. It would seem appropriate that all authorizations and instructions of a continuing nature be incorporated in the equivalent of Attachment II. It might be well for these authorizations to be reviewed annually, probably at the March meeting. With these purposes in mind, I suggest the following changes in Attachment II:

Section 1 would be similar to No. 7 under Attachment I, namely, "The Federal Reserve Bank of New York is selected as the Federal Reserve Bank to execute transactions in the open market pursuant to authorizations and directions issued by the Federal Open Market Committee."

Sections 2 and 3 would be similar to the present Sections 1 and 2 of Attachment II; however, in the interest of clarity, I prefer Mr. Allen's wording.

Section 4 would cover authority to execute repurchase agreements similar to that included in Section 6 under Attachment I and Section 3 under Attachment II. A combined authorization covering repurchase agreements might be stated as follows: "Repurchase arrangements in Government securities and prime bankers' acceptances may be entered into with nonbank dealers in order to help carry out the Committee's policy directive. Purchases made under this authorization shall be (a) limited to Government securities and bankers' acceptances having remaining maturities of X months or less, and (b) under resale agreements maturing in up to 15 calendar days. The rate on such agreements will normally be the discount rate of the Federal Reserve Bank of New York, but in no event shall the rate be below this discount rate or the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower."

Sincerely,



President