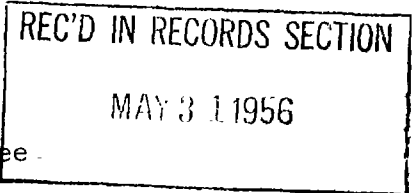


May 3, 1956

Confidential



To all Members of the Federal Open Market Committee and all Presidents not now serving on Federal Open Market Committee.

Chairman Martin's memorandum dated April 17, 1956 was for the purpose of making his personal position clear on the basic points raised in my memorandum of March 21 concerning our experience with the so-called "Continuing Operating Policies of the Federal Open Market Committee." In the course of making his position clear he succeeded in making my position unclear and I feel that a rebuttal is necessary.

I have come to the conclusion, however, that little is to be gained in the way of constructive development of System open market policies by having the Chairman and me fire broadsides at one another at long range. Such debate tends to introduce an element of personality or centers of influence, which obstructs objective consideration by those who do not want to be considered as aligned with one side or the other. My rebuttal of the Chairman's memorandum will, therefore, be in the form of an annex to this letter and is not intended for current discussion.

The purpose of the letter itself is to suggest that the Federal Open Market Committee at its next meeting take the following actions:

1. Authorize and direct that a staff committee be appointed to study the facts of our experience with present operating procedures. This would be spade work. Discussion of the substance would then take place in the full Committee and the value judgments would be made by the Committee.
2. Suggest to the Treasury that a joint staff committee be appointed at the technical level to study matters involved in the coordination of debt management and credit policy. This study could include such problems as:
 - A. The feasibility of experiments with various techniques for issuing new debt instruments intended to minimize the collision between debt operations and System policy. Mr. Riefler's recent memorandum suggests one such experimental technique.
 - B. The significance of the maturity schedule of the outstanding marketable debt as it relates to the investment needs and liquidity requirements of the economy at large. Our memorandum of September 29, 1955 and the memorandum from the Board staff prepared in the spring of 1955 on the need for more bills have touched upon some aspects of this problem.

C. The effects on credit conditions, interest rates, and the availability of funds at different maturities resulting from various alternative methods of using the Treasury surplus to withdraw marketable debt from the market.

We should not approach the Treasury, however, with the conviction that all would be well if the Treasury would only change some of its practices. What will probably be needed is a compromise of views with the Treasury, in order to obtain the best possible working arrangements.

3. Arrange to be kept currently informed by the New York Bank of the progress being made by a committee of the New York Clearing House, being set up in response to my suggestion, to study the functioning of the money market with particular reference to the financing of Government security dealers and the clearing arrangements for Government security transactions. While it is preferable to have suggestions come from the market for its own improvement, the Federal Open Market Committee should be prepared to act promptly in evaluating the results of the Clearing House study and to take action, if action on its part seems desirable, when the Clearing House report is completed.
4. Request the appropriate arm of the System to make a study of the Federal Funds market as it has developed over the past two or three years. This would seem to be necessary if we are to have a better understanding of the inter-regional flow of funds, and should contribute to effectiveness of the day-to-day operations of the System Open Market Account.

In addition to these longer range projects, it seems to me that the Committee should give immediate consideration to the following:

5. Operations in short term Government securities other than Treasury bills.

The supply of Treasury bills in the System Account has now become so low - approximately \$350 million - as to suggest that the Manager of the Account should have some discretion as to operations in other short term Government securities of up to twelve or fifteen months maturity. This suggestion is concerned not only with the depletion of our bill holdings, but also with possible distortions in the bill market which our operations may accentuate, causing bill yields to change widely and sharply, quite apart from underlying conditions in the money market. In view of the large volume

of Treasury bills which has been pretty effectively removed from active trading, and the small volume of our holdings it would seem desirable to widen the area of our operations.

6. Limited authority to make swaps in Treasury bills. Because of redemptions of entire maturities and because of market preferences for other maturities when we have sold outright it has proved almost impossible to keep anything like an even balance of holdings in the different bill maturities in the System Account. It would be most useful if swaps among bills could be authorized to help rearrange the bill maturities in the Account. The Committee could authorize the Account Management to make offsetting purchases and sales of Treasury bills for the purpose of altering the maturity distribution of the System Open Market Account when, in the Manager's judgment, such purchases and sales would not distort the functioning of the market, and would improve the capacity of the Account to perform effectively in supplying or absorbing reserves.

These are specific suggestions, with a limited amount of controversial content, which I hope will recommend themselves for adoption by the Federal Open Market Committee.

Yours faithfully,



Allan Sproul, Vice Chairman,
Federal Open Market Committee.