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THE NEW MONETARY POLICY

BY SIDNEY WEINTRAUB

THE first few months of the Eisenhower administration witnessed the institution of a monetary policy which, despite certain changes that can be characterized as a retreat, appears to reflect the philosophy of the new regime in this field. The chief architects of the new policy are the Secretary of the Treasury, George S. Humphrey, and his Deputy, W. Randolph Burgess, with the manifest approval of the Chairman of the Board of Governors of the Federal Reserve System, William McC. Martin. Substantially the motivating ideas seem to coincide with views expressed by Mr. Burgess in the past, when he was Chairman of the Executive Committee of the National City Bank of New York.

The new policy did not escape criticism from the Democratic opposition: on April 13, 1953, a group of eight Senators issued a public statement attacking the program, and a month later, on May 10, thirteen members of the House and seven in the Senate introduced a resolution proposing that the new measures be rescinded. But because of their technical nature and their slow-moving incidence, these measures did not arouse any public storm, either in protest or in defense. In early August, however, Mr. Marriner Eccles, in an analysis prepared at the request of Senator Paul Douglas of Illinois, denounced the new monetary policy as unjustified by events and as having led to "the virtual collapse of the government bond market after a five months' trial" (press release dated August 3, 1953, from Senator Douglas' office). At the same time Senator Douglas disassociated himself from the new policy, on the grounds that it errs in a deflationary direction. It will be recalled that Senator Douglas, a professional economist himself, was often at odds with the monetary measures of the Truman administration, arguing that they provided an engine for inflation. A similar attitude led to Mr. Eccles' demotion from his post as Chairman of the Reserve Board in 1948, and to his ultimate resignation in 1951.

Since the topic is important and the differences of opinion profound, it is desirable to consider the policies announced by the Eisenhower administration and the steps taken to implement them, and also the economic backdrop against which they operate and the developments under them.

Action and Policy Statements

In his first State of the Union message to Congress on February 2, President Eisenhower declared that monetary policy and debt management would be so designed as, first, to check inflation, and second, to refund the national debt from its substantial short-term nature into a more predominantly long-term form. Voicing his opposition to direct price controls such as those represented by the Office of Price Stabilization, the President declared that the Federal Reserve System would be unfettered in dealing with inflationary phenomena. On the matter of refunding, an effort would be made, despite the greater interest drain on the Treasury, to convert maturing short-term borrowing instruments into longer-term obligations. Both points presaged higher carrying charges on the national debt, with economies to be made elsewhere.

In view of the emphasis given to refunding operations, it is instructive to examine the composition of the national debt at the time the new administration took office.

At the end of January 1953 the national debt totaled $267 billion. Of this, $21.7 billion consisted of ninety-day Treasury bills; and this means that at the expiry of that period the Treasury must reborrow the same amounts to pay off the present owners of the obligations (unless the Treasury is operating at a surplus—but we are speaking of times in which deficits in fact prevail). Normally this reborrowing does not occasion any hardship, for the existing owners generally subscribe to the new issue, and thus the latter effectively redeems the former.

Certificates of indebtedness, which have a one-year life span, totaled $16.7 billion. Of the remainder of the national debt—consisting of Treasury notes with a usual maturity of three to five years, and of Treasury bonds, of which the longest issues run for twenty or even thirty years—a total of approximately $37 billion was to expire before the close of 1954 and hence, from the market standpoint, was considered relatively short-term.

The total of bonds and notes expiring through the full four years of the Eisenhower regime will be $55 billion. Altogether, including also the bills and certificates—but entirely apart from sums required to finance deficits—the Eisenhower administration will be dependent on the money market to refinance a total of at least $93 billion in debt obligations. This omits the possible redemption of savings bonds in excess of new sales (in 1952 net redemptions amounted to $370 million while in 1951 they were $1.1 billion, but for the first eight months of 1953 sales of savings bonds exceeded redemptions by $188 million).

The composition of the gross direct national debt at the end of January and of July is shown in the accompanying figures (in millions of dollars).[1] It is clear that in these six months there was little discernible change in the composition of the debt. The increase of some $5 billion was due to the need to finance the deficit of the fiscal year ended June 30, 1953, and to provide funds to

	January 31, 1953	*July 31, 1953*
Treasury bills	$21,709	$20,207
Certificates of indebtedness	16,712	21,756
Treasury notes	30,275	30,455
Treasury bonds	92,368	93,649
Savings bonds	58,134	57,871
Tax and savings notes	5,676	4,706
Special issues	39,097	40,594
Non-interest-bearing issues	3,431	3,431
Total	267,402	272,669

[1] Data from *Federal Reserve Bulletin*. The "special issues" are primarily bonds issued to the Social Security Fund.

cover an expected $4 billion deficit in the current fiscal year. Practically all of the increase was in certificates of indebtedness, a short-term borrowing instrument and thus hardly conforming with the specified program of lengthening maturities.

As was mentioned above, bonds and notes in the amount of $37 billion are to fall due for retirement and refinancing before the close of 1954. Between the end of January and the end of September 1953 the total of expiring securities of all types amounted to about $47 billion. The accompanying tabulation (amounts in millions of dollars), which discloses the nature of these issues and the market obligations offered by the Treasury to replace them, as well as two issues designed primarily to raise new funds, offers a concise and graphic schema of debt-management policy over this period.

It is apparent that all of the refunding operations have placed heavier interest burdens on the Treasury. On the three certificate-of-indebtedness issues and the two expiring bonds the rise in annual charges amounts to about $84 million. And much the same is true of Treasury bills, where the annual cost, compared to last year's rates, has gone up by some $70 million. It is estimated that even if interest levels go no higher, and if the forthcoming refunding operations consist of new securities of existing types to replace matured issues, the annual interest cost to the Treasury at the end of fiscal 1956 is likely to be almost $1 billion in excess of the $4.6 billion sum for fiscal 1953.

With each new issue offered by the administration, financial journalists have commented that the terms were regarded by market dealers as generous, meaning that rates were above ruling patterns. This is further evidenced by the generally low levels of "cash-ins" in lieu of accepting the new certificates: as a rule, upwards of 90 percent have elected to accept the new offering, and the Treasury has invariably publicized the low cash "attrition" rate. The failure to issue long-dated securities has been due, as we shall see, to the plight of the 3¼ percent issue, which at the time of its announcement was also heralded as proffering generous

REFUNDING

Maturing Feb.-Sept. 1953	*Refunding Issues*
TREASURY BILLS	
Outstanding end of January: 15 issues totaling $21,709	Outstanding end of July: 14 issues totaling $20,207
CERTIFICATES OF INDEBTEDNESS	
1⅞% issue dated Feb. 15, 1953, in amount $8,868	2¼% issue dated Feb. 15, 1954, in amount $8,114, or 2½% bond dated Dec. 15, 1958, in amount $620
1⅞% issue dated June 1, 1953, in amount $4,963	2⅝% issue dated June 1, 1954, in amount $4,858
2% issue dated Aug. 15, 1953, in amount $2,882	2⅝% issue dated Aug. 15, 1954, in amount $2,788
TREASURY BONDS	
2% issue dated June 15, 1953–55, in amount $725	2⅝% certificate of indebtedness dated June 1, 1954 (refunded simultaneously with the 1⅞% June 1 certificate issue)
2% issue dated Sept 15, 1953, in amount $7,986	2⅝% cert. of indebt. dated Sept. 15, 1954, in amount $4,722, or 2⅞% note dated Mar. 15, 1957, in amount $3,000

NEW FINANCING

3¼% Treasury bond dated May 1, 1953, to June 15, 1978–83, in amount $1,603, sold for cash or in exchange for Series F and G savings bonds maturing May–Dec. 1953

2½% tax anticipation certificates (which may be used in paying taxes) dated July 15, 1953, to March 22, 1954, in amount $5,902

terms. The almost disastrous early history of this issue will be discussed presently.

Even if the aim of reducing the volume of short-term indebtedness has not been fulfilled—and the first tabulation above shows more imbalance in July than in January between bills and certificates on the one hand and long-term forms on the other—there is no doubt that the Treasury has promoted a rise in interest rates. This result arises from its belief that inflation is the key economic danger, and that its course is due to the "artificially low interest rates" under predecessor Democratic administrations. Secretary Humphrey, for example, alleged at an Associated Press luncheon on April 20 that for several years "we have artificially manipulated our interest rates" and created inflation; and Mr. Burgess has made similar statements both before and since taking office (the *Monthly Letter of the National City Bank,* published by his former banking firm, condemns the "artificially low interest rates" of the past almost as a matter of course).

The accompanying figures (from the *Federal Reserve Bulletin*) show the movements of interest rates and yields on government securities over recent months in comparison with average figures over recent years. The trend and the magnitudes are clear. In general the movement since October 1952 can be ascribed to the new administration, for with the election returns in, and the campaign views known, rates started moving up. It is well known that in this field today's price—and interest rates are prices for money—

	Treasury Bills *(New Issues)*	*9–12 mo.* *Maturities*	*3–5 yr.* *Maturities*	*Long-Term* *Bonds*
1950 average	1.22%	1.26%	1.50%	2.32%
1951 "	1.55	1.73	1.93	2.57
1952 "	1.77	1.81	2.13	2.68
Sept. 1952	1.79	1.95	2.28	2.71
Oct. "	1.78	1.84	2.26	2.74
Nov. "	1.86	1.89	2.25	2.71
Dec. "	2.13	2.03	2.30	2.75
Jan. 1953	2.04	1.97	2.39	2.80
Feb. "	2.02	1.97	2.42	2.83
Mar. "	2.08	2.04	2.46	2.89
Apr. "	2.18	2.27	2.61	2.97
May "	2.20	2.41	2.86	3.09
June "	2.23	2.46	2.92	3.09
July "	2.10	2.36	2.72	2.99

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reflects opinion on what tomorrow's price is likely to be. The slight downturn and softening of interest rates after June 1953 manifests the easing of the money market consequent upon the "retreat" in monetary policy.

After this examination of the relevant facts let us consider some of the public pronouncements on monetary and debt policy. The remarks, as much as the actions, of responsible Treasury and Reserve Board officials not only put events in better perspective and provide clues to official thought patterns concerning future actions, but also help shape the opinions, outlook, and investment behavior of money-market participants. It will be seen that some statements were ill advised, being badly timed and also, as Mr. Eccles has pointed out, incapable of realization.

As late as June 24, on the very day the Reserve Board announced a reduction of member-bank reserve requirements in order to ease the money supply and interest rates, Secretary Humphrey was quoted in the press as denying that this meant any retreat from a "hard-money" policy. Explaining his position further, and thereby partially modifying it, he declared in a speech that "instead of hard money the goal of this administration is honest money." In words reminiscent of Franklin D. Roosevelt he volunteered that "honest money" is money of constant purchasing power, and went on to say that the new administration has "assured the Federal Reserve that it will have the prime responsibility for maintaining the money and credit situation free of artificial restraints in the best interests of all Americans," adding that since the 1951 accord between the Treasury and the Reserve Board "the Federal Reserve System has been helping to promote an honest dollar by not artificially enlarging the supply of money for the purpose of keeping the interest rates on Government issues low." [2]

Mr. Burgess, in a speech on "Principles of Treasury Policy" delivered on May 12, presented a clear exposition of his views, without equivocation or evasion.[3] He criticized past Treasury

[2] See *Commercial and Financial Chronicle,* August 6, 1953.

[3] See *ibid.,* May 14, 1953.

borrowing from commercial banks on the ground that by increasing the money supply it was inflationary, and proposed that in order to avoid inflation the borrowing be confined to the absorption of savings. He went on to say that "The policy of financing the Government by placing short-term securities in the banks and then calling upon the Federal Reserve System to support the price of government securities . . . had much the same effect as printing so much money."

To avert this he enunciated the principles governing the Treasury's actions: "The first rule of Treasury policy today is that the Federal Reserve System shall be free to exercise its policy without interference," and "this means . . . that the Treasury must sell its securities in the market at the going rate of interest and not at an artificial rate supported by the Federal Reserve System. The second rule is that more government securities must be sold to nonbank investors. Too much of the debt is now concentrated in the banks. This cannot be changed abruptly; but over a period gradually it is proposed to distribute the debt more widely as a necessary step for economic stability. These, then, are the principles of the Treasury in its new program of financing."

In an interesting and revealing non-sequitur he then continued: "The old law of supply and demand is forcing interest rates higher. Also, the Federal Reserve System . . . has been keeping the money market tight." But with respect to the 3¼ percent issue he declared, "We did not make the rate; that was set by the market." And referring to the practice of individuals in subscribing to securities in the expectation of reselling them at a profit shortly after issue, when they would ordinarily go to premium levels, he said that "the free rider, accustomed to pegged markets, had a wholesome lesson" when the 3¼ percent bonds were issued, but in the making of subscription allotments he "must be more carefully screened next time."

Cognizant of the criticism that deflation rather than inflation was the problem, Burgess acknowledged that there were some weak spots in the economy, but observed that income, employment, and production were at record levels. Hence he concluded that "deflation is as yet a guess, not a reality."

Chairman Martin of the Reserve Board delivered an important statement of his views before the Economic Club of Detroit on April 13, the topic being "The Transition to Free Markets." It will be recalled that Mr. Martin was Undersecretary of the Treasury under Mr. Truman, and was named to the post of Mr. Eccles' successor, Thomas McCabe, when the latter returned to private life. In the course of his address Mr. Martin had this to say:[4]

> ". . . the Federal Reserve decided last December to refrain entirely from purchasing maturing securities. . . . Again in February, when the Treasury refinanced a large maturity with an attractive offer no support was given by the System. Both refundings were highly successful and demonstrated the value of reliance on freely functioning markets rather than on official intervention.
>
> "The transition has major advantages to the System, to the Treasury, and to investors in general. The System no longer needs to inject periodically into credit markets large amounts of reserve funds which are difficult to withdraw before they have resulted in undesirable credit developments. On the other hand, private investors, whose funds the Government seeks to attract, may now fairly appraise a new Government security offering through market processes. They may invest in the new issue with confidence that its market price reflects not just an arbitrary decision by the Treasury and the Federal Open Market Committee but instead the composite evaluation of its worth by thousands of investors in the light of their judgments as to the current and prospective demand and supply of credit. . . .
>
> "As investors continue to operate in a free market for Government securities I am fully confident that they will develop a fuller understanding of the minimum role to be played by the System in such a market."

This is a remarkable statement which, in the course of time, is almost certain to be widely quoted and taken as a mystifying declaration. It is not often that the chairman of a central bank proclaims its abdication of control over interest-rate movements by

[4] *Federal Reserve Bulletin,* April 1953.

an announced withdrawal from the market for government bonds; ordinarily the price movements of such bonds set the tone for the whole interest pattern. To adhere to Mr. Martin's precepts would mean that hereafter the Reserve System, rather than seeking to control interest rates in fulfilling its functions as a central bank, would become a follower instead of a leader in the money market.

It was this novel doctrine that prompted Mr. Eccles' castigation in his analysis for Senator Douglas, to wit: [5] "If the Federal Reserve System discharges its responsibility, there is no such thing as a free market as indicated by Chairman Martin. That concept was meant to be discarded when the Federal Reserve System was established in 1913. It is the function of the Federal Reserve System to maintain economic stability so far as that is possible within the scope of monetary and credit management."

Under Mr. Martin's guidance the Federal Reserve System reduced its holdings of government obligations from $24.7 billion at the end of December to $23.8 billion at the end of March, thereby contributing to the destruction of $900 million of reserve balances and about $4.5 billion of potential bank credit.

These various remarks and the ensuing actions do not merely represent philosophic disputations without immediate relevance. They have affected interest rates and the present as well as the future course of business in its significant income, output, and employment dimensions. They have also produced a drama in the bond market, in which a bond issue has been tossed into jeopardy and subsequent long-term financing has been hamstrung.

In February Professor Marcus Nadler, an astute student of the daily ebbs and flows of investment demand, asserted, in appraising the money-market situation, that the market was ripe for a 3 percent thirty-year issue, and that these terms would be "generous." [6] Similarly, the *National City Bank Letter* for February stated (p. 18) that "the general impression is that the Treasury can borrow at long-term within the interest rate range of 3 to 3¼%."

[5] August 3, 1953, press release from Senator Douglas' office, p. 6.

[6] New York *Times*, February 11, 1953.

On April 8, 1953, the Treasury announced a new issue whereby it proposed to borrow $1 billion at 3¼ percent for thirty years. Subscriptions were to be opened on April 13, with the issue to commence on May 1. On April 22 the Treasury announced a successful flotation, explaining that subscriptions were five and one-half times the original offering. Mr. Burgess was quoted as saying to the press that inflation was still the problem, and that the 3¼ percent rate was low if it helped maintain stability; he declared too that subscriptions were larger than anticipated, and that it was not to be assumed that future issues would be anchored to a 3¼ percent base.[7]

Trading in the bonds, on a "when issued" basis, began April 15. On Monday, April 27, there occurred something almost unprecedented in the government-bond market: the new issue sold below par. This meant that dealers in the bonds who had bought with an eye to resale would face a loss in so doing. Such an experience would jeopardize the course of future long-term financing, for nobody, least of all professional traders, would be likely to subscribe to an issue that could go to a discount before issue date and could be picked up in the market at a lower price than in subscription from the Treasury. It was this event that evoked Mr. Eccles' remark about the "collapse" of the bond market: if it taught the "free riders" a "wholesome lesson," as Mr. Burgess averred, another such "lesson" might cause investors to shy away altogether from bond buying. The experience with this issue has undoubtedly inhibited subsequent long-term Treasury refinancing.

Why did the bond issue break par? If one looks at Mr. Martin's speech, as well as at Mr. Burgess' statement that interest rates were still low, one has a good part of the answer. If responsible officials indicate, despite new supplies of securities and rising business conditions, that new money will not be available and that interest rates might go higher, they are in effect telling bondholders to sell now and buy back bonds at a discount later on, when the rates harden and bond prices fall. Heeding this advice,

[7] New York *Times*, April 23, 1953.

as well as the entire tone of official remarks, bondholders were well advised to sell. Also there was Mr. Martin's assurance that the Reserve System would not intervene to safeguard against a fall, and that what occurred would represent a "composite evaluation by thousands of investors."

Watching the market developments with what must have been consternation if not alarm, the Reserve Board hastily abandoned Mr. Martin's strictures. Between April 29 and June 17 it bought $1,348 million of government security issues. On June 24 it announced, despite Mr. Martin's scruples about "injecting new reserve funds," that reserve requirements were to be reduced, with the result that the lending power of commercial banks would be expanded by some $5,750 million. With this announcement—and the demonstration of positive action by the central authorities in the money market, promising that new funds would be available—the new 3¼ percent issue sold at par, for the first time since the issue date. Since then, with the easing of money rates accompanying the retreat in monetary policy, the issue has tended to hover slightly above par.

Issues and Doubts

Turning to an appraisal of the new policies, we may consider the validity of the tight-money policy in itself, the level of rates realized, the prudence of the several policy pronouncements, and, above all, the theory permeating all these moves, that is, the manifest aversion to "artificial interest rates."

First, was a tighter money policy warranted in the circumstances prevailing when the new administration and its Treasury team took the reins? Almost without interruption the index of consumer prices had risen from a value of approximately 77 for the last war year 1945 to a value of 114 for 1952. Wholesale prices had followed the same path, reaching a value of 112 in 1952 from 69 in 1945. But the index of farm products at wholesale had been declining for five months when the Eisenhower regime assumed responsibility, dropping from 110 in August 1952 to 100 in January 1953. The same was true of processed foods, according to the index data, while other commodities held rather firm. Consumer prices, reflecting the rent rises consequent upon widening decontrol, higher wage rates, and rigid prices of consumer services, were tending to fall at a slower tempo; but a microscopic downward movement was evident, as indicated by the index fall from 114.3 to 113.9 over the same five months. It was plausible, too, to expect the "disinflation" in wholesale levels to be transmitted, with some lag, to retail prices.

Further, it was generally known that military expenditures were due soon to reach their peak and then taper off. Besides, the new administration was pledged to reduce government outlays, barring only the emergence of still greater tensions with the Soviet or the catastrophe of atomic war.

Thus in January 1953 there could have been legitimate differences of opinion among reasonable men as to whether inflation or some deflationary downturn was the imminent problem. Essentially, the responsible Treasury people seem to have discounted the latter possibility. But although higher interest rates constitute the proper medicine in an economy that is expected to display an inflationary surge, the Treasury, in adopting this course, also acquiesced to the immediate lifting of all price controls and the February 20 reduction of margin requirements on stock-market purchases. These seem like very contradictory antidotes to be administered to a patient believed afflicted with inflationary tensions.

If tight money was to be enforced, moves against instalment credit and nominal down payments on home purchases might also have been invoked. The failure to take these steps attests to a singular faith in the efficacy of mere changes in interest rates and to an apparently inflexible resolve against other methods. Such other measures certainly belong, however, to the general family of credit and indirect controls often espoused by those who, agreeing that inflation must be checked, find direct price controls repugnant by virtue of their bureaucratic complexion.

Even if inflation was not an unreasonable surmise in January, and even if higher interest rates to the exclusion of other control techniques were adequate for the job of checking it, the question arises whether the actual levels to which interest rates were permitted to go were warranted in the light of the facts, or whether they were pushed up with unseemly haste.

The last tabulation above has shown how interest rates inexorably advanced during the first six months of the new policy, before the reversal engineered by the Federal Reserve in late June. Considering the debatable nature of the inflation issue at the beginning of 1953, it seems that the Treasury might have proceeded with more caution in its policies. A more guarded approach would have countenanced one or two gestures in the direction of higher interest rates, to place the economy on notice that monetary policy would be peremptorily employed if inflation did develop.

In actual fact, as we have seen, the evolving price events over the half-year were not wholly inflationary in nature, nor were production, employment, and construction; the latter, in particular, was turning down. And yet the flight of interest rates was permitted to continue over the several months, as if the authorities were bent on accomplishing higher levels "come what may"—including the added burden to the Treasury. Even after the Federal Reserve about-face, this still seemed to be the attitude of the Treasury officials who were critical of low interest rates.

Apart from the wisdom of the cumulative interest push-up, there is a question whether all Treasury rates should have been permitted to advance almost in step and in the same degree. The administration was committed to control of inflation and to extending the maturity of the national debt. To control inflation it was essential, as Mr. Burgess stated, to curb commercial banks' subscriptions to the obligations offered, and to begin reducing their total security portfolios. But banks constitute the main class of subscribers to Treasury bills and certificates. If rates on these had been restrained while those on longer bond issues were advanced, the entire policy would have been more consistent with

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the avowed declarations of higher interest rates for attracting nonbank investors and extending the term of the debt.

As matters stood, those who preferred short to long maturities had scant reason, ratewise, to alter their preference, inasmuch as the entire rate structure moved up almost proportionately. Ironically, as they were being told that the future would bring still higher interest phenomena there was even more reason than before to concentrate on short-dated maturities, whose prices are less sensitive to changes in interest rates.

It has already been indicated that the various policy announcements just prior to the 3¼ percent offering of May 1 were imprudent and in part responsible for the near-debacle that attended its marketing. It may be constructive to inquire just how far the monetary authorities ought to go in conveying views on forthcoming policy to dealers in the money market, who scan their every word for a clue to the unknown future. From what has been said it may appear that they ought to indulge only in generalities buttressed by platitudes.

Though these remarks are not intended as a primer in speechmaking—those in responsible posts are seldom lacking in noble sentiments and grand phrases—it seems clear that what ought *not* be said, in a situation in which government securities are being offered and the authorities are interested in the success of the offering, is that the terms of the offering, though good, are poor by standards that may soon be attained. It is hard to sell automobiles today when you inform your customers that a lower price will be available in a few days.

To hold a market together, with narrow price movements and active trading, there must be a substantial diversity of views on future rates of interest. If everyone comes to think alike, prices will move rapidly to the levels of the unanimity, even without any transactions taking place. These propositions have important implications for monetary policy. Only when the monetary authorities want to alter the general rate level ought they seek to foster certainty and unanimity, to the effect that this new level will be realized and maintained. If they want to maintain a particular rate structure without participating actively in open-market transactions, they must induce a diversity of views, so that demand for long and short securities will remain in good balance. Diversity can result only when the market is relatively uninformed, guessing and unsure of the monetary authorities' intentions, with any crystalizing of market sentiment in one direction dissolved by contradictory central bank behavior. Apparently in the first months of 1953—until the Federal Reserve intervention and policy retreat—feeling was rife, fostered in part by the various pronouncements, that interest rates would rise. This made inevitable a lift to higher ground, with the movement tempered only by some pessimism as to the future course of business.

The concept of "artificial interest rates," of which Secretary Humphrey and Deputy Burgess are so disdainful, is difficult and elusive to deal with, primarily because they have not taken any pains to define precisely what they mean by it. Often the phrase seems to be merely a reproach of low interest rates. At other times Federal Reserve action in the government-bond market seems to be what is reprehensible.

Not so long ago the economic literature of the Knut Wicksell genealogy suggested that the "natural" rates of interest are those that would be realized in a barter economy where money is nonexistent. But these views were discredited when it was pointed out that a barter economy would be hopelessly inefficient if applied on a wide scale in contemporary society. And once money is introduced, inasmuch as it is a new element in the economy, subject to choice and valuation, the results cannot possibly be the same as under even a smoothly working barter mechanism.

After this version of "natural" rates was discarded, it was suggested that interest rates be known by their effects, that the "natural" rates are those that keep the price level stable and equate the rate of saving and investment. And when it was shown that these twin objectives might be mutually contradictory, the concept of "natural" interest rates received a practically mortal blow. Lord

Keynes suggested that if we want to preserve the term we should allot it to that interest structure that would maintain full employment. Apparently, however, it is not this meaning that is intended when "artificial rates" are being condemned by policymakers, for we have had full employment in a practical sense over recent years, albeit with inflation.

Sometimes, in more popular usage, the epithet "artificial" has been hurled at the Federal Reserve practice of supporting government bond prices at a fixed peg. Objections of this sort may or may not be warranted, depending on circumstances. But this is an objection to a particular interest policy, and it should not carry the confusing and emotional implication that another policy would be more "real" or "natural." *Anything that the Reserve System does in this area is "artificial," for it is wholly attributable to human decision and judgment.* To decry one policy as "artificial" and commend another as "natural" is to engage in word flavoring rather than analysis.

Surely it cannot be contended that all Federal Reserve dealings in government bonds are "unnatural" and undesirable, for this would amount to a denial of the role and efficacy of "open-market operations," which are a key weapon in the armory of central banks. If this is the Treasury view it ought to be stated publicly and candidly. Acceptance of this position would entail a radical overhaul of our central banking mechanism.

Sometimes the phrase is intended to imply that Federal Reserve dealings in government bonds, either immediately before or immediately after issue dates, are morally unsavory and constitute market "rigging," as the phrase goes. Those who hold this view would seek to circumscribe the timing of Federal Reserve policy. Such action, if made a hard and fast rule in an era of frequent government offerings, would come close to precluding open-market operations. It is doubtful that this would be a happy restriction of the Reserve System's power and freedom of action.

Furthermore, the suggestion that the Reserve System be prohibited from influencing the climate of the money market, either before or after offering dates, constitutes a strange attitude for individuals whose experience derives from the business world. It is an accepted, common, and legal practice in the flotation of non-governmental securities for the underwriters to "stabilize" the prices of the securities before and after issue date, often with the use of bank funds. If warranted there, why not in government securities?

The suspicion and evil cloud of "artificiality" does not seem to hover about other Reserve System manoeuvres, such as altering reserve requirements; at least they have not been denounced in this way. Yet the difference between this type of action and open-market operations is at best one of degree, for whereas the latter alters the amount of securities in the hands of the market and affects excess reserves, the former first affects excess reserves and then leaves it to the commercial banks to absorb or release securities in dealing with other holders. Actually, the altering of reserve requirements, since it is more dramatic and more publicized than open-market operations, might be alleged to be the most "artificial" step of all.

If the changing of reserve requirements is subject to the same censure of artificiality, we can only conclude that those who use this term are opposed to any vital central banking actions whatever, particularly those that augment the money supply. And if this is the correct interpretation we ought to be apprised of it before the deflationary consequences engulf us in an economic disaster, for a growing economy needs a growing money supply to avoid deflationary consequences. It is the legitimate task of the central bank to provide this money supply, unless it is to renounce its obligations and responsibilities.

Finally, it may be that the "artificiality" concept is intended to signify merely that interest rates are low by historical standards. This may be true and yet unimportant. We are interested in the *effects* of interest rates, not in fastidious relationships of historical detail. Nor are we interested in reimposing past patterns for their own sake. The agricultural assistance program, with its attempt to restore relationships prevalent before World War I, is not an illustration of overwhelming triumph in twentieth-century economic policy.

In sum, the record over the first six months of the Eisenhower administration often makes it appear that higher interest rates were sought almost as ends in themselves. And at the same time the Chairman of the Federal Reserve System came very close to promulgating a new doctrine tantamount to an abdication of traditional central bank responsibility, with the demise of some of its primary functions. Fortunately this thinking seems to have been arrested without any indelible effect on the remainder of the Board: in June its responsibilities were asserted and its control over the money market restored. Only the future, however, will reveal whether the Treasury is indeed wedded to an objective of higher interest rates than those prevailing, or whether it will acquiesce in a rate structure designed for economic stability, without the inflation of the recent past or the deflations of even less lamented memory.