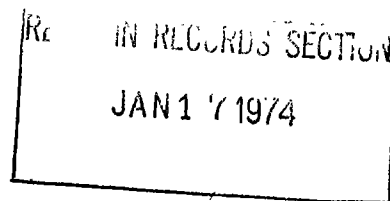




BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551



January 16, 1974

To: Federal Open Market Committee

From: Robert C. Holland, Chairman, Committee on the Directive

I am enclosing for your information an outline of the research program of the Committee on the Directive. Jim Pierce will be directing research for the Committee, and he will shortly be in touch with members of your staff who might contribute to our work.

We are well aware that a great deal of research has already been done on many of the questions contained in the outline. Moreover, many of the policy issues have been considered by earlier directive committees. We expect that this past work will facilitate our task, and therefore hope that we can come to judgments in a reasonable time period and without an excessive absorption of System resources.

We would plan to send forward interim reports to the FOMC as significant phases of the work are completed.

Jan 16

RESERVE IN TARGETS SECTION

JAN 17 1974

Research Program for Committee on the Directive

I. Questions with regard to intermediate target variables

A. What are the properties of optimal intermediate target(s)?

Under what conditions is it helpful to interpose an intermediate target between immediate operating targets and the ultimate targets themselves? What are the tradeoffs as among controllability of the intermediate target, frequency with which observations are available on the target, and the degree of predictability of the impact of the intermediate target on the ultimate objectives of policy? What are the relevant time frames for attempting to hit the intermediate target?

B. What, in practice, would have been the differential effects of various intermediate targets -- such as  $M_1$ , bank credit, or interest rates -- on financial markets and the economy generally, during various periods of restraint -- 1966-67, 1969-70, 1972-73? For example, as gauged by analyzing the flow-of-funds accounts, did use of bank credit as a target in the earlier periods affect only the distribution of credit, with the level of market interest rates and real economic effects determined more by the behavior of  $M_1$ ? Could the same objectives have been accomplished by the use of  $M_1$  or interest rates as targets?

C. What are the pro and con arguments for various monetary aggregates as intermediate targets?

(1) A reserve aggregate (monetary base, nonborrowed reserves, total reserves, etc.)

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- (2)  $M_1$
- (3) Broader money supply
- (4) Bank credit
- (5) Private liquid assets

D. What are the pro and con arguments for various rate of return measures as intermediate targets?

- (1) Short-term interest rates
- (2) Long-term interest rates
- (3) Return on equity

(Include in the analysis of questions C and D any institutional factors favoring or limiting the variable, the time horizon over which control may be relevant, implications for credit distribution, and implications for the timing of policy effectiveness).

E. What is the potential role for qualitative judgments as intermediate targets -- e.g. market attitudes and expectations, tone and feel? Should quantitative specifications be augmented by judgmental "feel"? Are uncertainties sufficiently great that qualitative considerations should replace or supplement, quantitative specification?

F. Can combinations of intermediate targets effectively serve the purposes of monetary policy, and, if so, how should targets be linked (e.g. under what circumstances and for how long might particular combinations be maintained), how should priorities and tradeoffs among targets be set and how should conflicts among them be resolved. Should ranges of tolerance be used for the targets?

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- II. Questions with regard to operating targets in the interval between Committee meetings.
- A. How do alternative reserve measures (total, nonborrowed, RPD, monetary base, etc.) perform -- in terms of the empirical evidence and in light of various methods for estimating multipliers -- as operating targets to achieve objectives for particular monetary aggregates?
  - B. What factors affect the feasibility of utilizing various reserve measures as operating targets in the interval between FOMC meetings, and how might the feasibility change over longer time periods?
  - C. What are the arguments and evidence for the desirability of using money market conditions as an operating target for purposes of achieving monetary aggregate objectives, or for purposes of attaining other intermediate term objectives? How should various components of money market conditions -- Federal funds rate, member bank borrowing, net borrowed reserves, 3-month bill rate -- be evaluated as operating targets?
  - D. Could the intermediate target be better attained by blending reserve and money market targets? If ranges should be used for these targets, what is the optimal width of reserve and funds rate ranges and how should trigger points for changing the operating target within ranges or for adjusting permissible ranges be determined?

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III. Questions to be addressed based on the results of the above projects.

- A. What kinds of changes in data and regulations deserve to be investigated as measures that might significantly improve the formulation and execution of monetary policy.
- B. What methods can be established to monitor the degree to which a particular policy -- either with respect to intermediate target or short-run operating strategy -- has been achieved and the degree to which it has met the FOMC's objectives.