

reactions to changes in interest rates and securities prices. We return to this subject in Part III below.

The 1961 edition expands the section on open-market operations still further. A new chapter has been added on "The Credit Market," the chapter on interest rates has been greatly enlarged, and the chapter titled "The Influence of Reserve Banking on Economic Stability" considerably reorganized; in all of these, open-market operations and their effects are intimately involved. Again, we shall return to this in Part III.

In addition, the 1961 edition devotes much more space than did its 1954 predecessor to "bills only" and the related ground rules adopted in 1953 for the conduct of open-market operations. The 1954 edition merely noted, almost in passing, that "Although such operations may be conducted in securities of any maturity, traditional reserve banking practice has been to limit transactions to short-term Government securities. Open market operations in these securities are rapidly communicated throughout the credit market by the mechanism of the market itself, as well as through their effects on bank reserves" (1961, p. 40; see also p. 46). The point was also made in 1954—and repeated in 1961—that "Traditionally, Reserve banking operations are not directed toward establishing any particular *level or pattern* of interest rates" (1954, p. 143).

In the 1961 edition, in contrast, seven full pages (1961, pp. 35–41) are devoted to the subject of "bills only" and related operating procedures. Basically, these pages repeat the arguments previously advanced by Riefler and Young-Yager for confining operations to the short end except to correct disorderly markets,⁹ namely, that the purpose of open-market operations should be confined to altering

bank reserve positions, that "bills only" will improve the performance of the Government securities market, that direct intervention in the intermediate or long sector is dangerous because it distorts the true demand-supply relationships and gives rise to unjustified expectations, and is unnecessary because the effects on bank reserves and the market forces of substitution and arbitrage will effectively transmit yield impulses throughout the maturity range. Fundamentally, the structure and level of interest rates should be left to the determination of private market forces: "While the course of interest rates is necessarily influenced by reserve banking action, monetary policy decisions are themselves based primarily on judgment as to the flow of bank credit and money that is appropriate for the economy, and not on judgment as to some level and pattern of interest rates that is deemed to be appropriate. To the greatest extent possible, the setting of interest rates is left to the interplay of supply and demand forces expressed in the credit and security markets" (1961, p. 122).

Unfortunately, the 1961 edition of *Purposes and Functions* made its appearance in February of that year, the very month in which "bills only" was abandoned. In the second printing—dated April, 1961—an attempt has been made to take this change in System policy into account, while at the same time retaining intact the bulk of the still-new fourth edition. On pages 35 and 41 statements have been inserted in the second printing to the effect that "In early 1961, in view of conditions that had developed in the

⁹ Winfield W. Riefler, "Open Market Operations in Long-Term Securities," *Federal Reserve Bulletin*, XLIV, No. 11 (November, 1958), 1260–74; and Ralph A. Young and Charles A. Yager, "The Economics of 'Bills Preferably,'" *Quarterly Journal of Economics*, LXXIV, No. 3 (August, 1960), 341–73.