

and thereby the money supply. It was implied that this in turn influenced aggregate spending, but there was no analysis of how this occurred or which particular types of expenditure might be affected.<sup>13</sup>

In the 1947 edition, the principal purpose of the Federal Reserve was seen as the regulation of "the supply, availability, and cost of money" in order to avoid both inflation and depression. But the only description of exactly how monetary policy contributed to this end was confined to a general statement to the effect that if the supply of money is "too scarce, too dear, or too hard to get" it will lead to depression, while if it is "too plentiful, too cheap, or too easily obtainable" it will lead to inflation. Relying on its control over member-bank reserves, the Federal Reserve evidently steered a middle course between Scylla and Charybdis.

The 1954 edition thus represented the first real attempt to explain the process, as the Federal Reserve saw it, through which monetary policy works. Both it and the 1961 edition utilize roughly the same framework for this analysis. Within that framework, however, a number of changes appear between 1954 and 1961, clearly reflecting both the experience gained and professional discussion in the intervening years. It will facilitate comparison to trace through the entire process step by step, comparing the 1954 with the 1960 analysis at each stage. At the risk of caricaturing a complex and subtle explanation in the interest of brevity, the following is the essence of the process of restraint as seen by the Board.<sup>14</sup>

<sup>13</sup> All editions of course mention that the structural reforms instituted by the Federal Reserve Act, such as establishing a lender of last resort, correcting the pyramiding of reserves, and making the currency more elastic, make financial panics less likely than before 1914.

1. The Federal Reserve puts pressure on member-bank reserve positions, initially probably through open-market operations, thereby hampering the banks' ability to make loans and create money. There is no difference between the 1954 and 1961 editions regarding this first step.

2. 1954: To some extent, the banks then turn to the discount window for additional reserves. However, such funds are only temporary at best. In addition, member-bank reluctance, administrative supervision of the discount window, and raising the discount rate in line with short-term market rates, all operate to limit recourse to this source of funds. The banks are thus forced to sell short-term government securities to obtain the reserves necessary to satisfy loan demands. While an individual bank can indeed augment its reserves in this fashion, this will draw reserves from other banks and no net addition to reserves will take place. "Consequently, banks as a group cannot expand their total supply of lendable funds in this way except when such paper is being bought by the Federal Reserve System" (1954, p. 126).

1961: The 1961 edition is the same as the above except for the substitution of the phrase "total loans and investments" for the expression "total supply of lendable funds" in the concluding quotation.

3. 1954: The sales of short-term securities by the banks, and perhaps by the System as well, if it wants to intensify the pressure, drive short rates up. With yields now more attractive, "nonbank investors may be induced to buy more of them, using temporarily idle deposit balances. Sales of short-term paper by banks

<sup>14</sup> Anti-depression policy is by and large explained as merely the opposite of anti-inflation policy. One possible exception is the view that if a boom gets out of hand it will make it more difficult for monetary policy to cure a subsequent recession.