MONETARY AND FISCAL OPERATIONS OF THE FEDERAL RESERVE SYSTEM

13 February 1958

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Publication No. L58-104

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

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ADMIRAL CLARK: Gentlemen, you remember that at the very beginning of the course the College provided a short refresher course in economics, during which we devoted ourselves almost entirely to the principles. We are now coming to a point where we are going to consider the application of some of these basic principles to the economic stabilization of the country when our economy is under unusual pressures.

I think we have only to pick up the daily newspapers to realize who the leader in the fight for stabilization is. In this position of leadership the Federal Reserve System has an extremely difficult, a continuously difficult, task, particularly in the area of balancing the needs of short-term versus long-term measures for that stabilization.

To tell us something about the monetary operations of the Federal Reserve System, we are very fortunate this morning in having one of the members of the Board of Governors of that System to address us here on the monetary and fiscal policies and operations of the System. He is Governor James L. Robertson. Governor Robertson has been in Government service for over 30 years, and a large part of his time has been devoted to monetary and fiscal affairs.

Governor Robertson, it's a great pleasure to welcome you to the College and introduce you to this Class of 1958.

GOVERNOR ROBERTSON: Admiral Clark and Gentlemen: I don't know just how to go about this; but if in the course of this talk it appears to me that there's a better way to approach it, that we should stop in the middle of these remarks of mine and start launching questions, that's the way we're going to do. And I hope that you will feel perfectly free to ask questions. Don't fear that I'll be embarrassed if I can't answer them. I know that there are many that I can't. If so, I'll try to get you the answers from those who do know.

It seems to me that there are an awful lot of problems which are facing the world today, and all of us look at them from a different point of view. I think that seeing them from the situs of my hometown, Broken Bow, Nebraska, is very different from seeing them from where I sit as a member of the Board of Governors. But from where I sit, one of the big ones that looms up is how to bring about a better public understanding of the Federal Reserve System, because I think that if that can be achieved, the lives and the welfare of every American and people throughout the world will be benefited. Really, that's the reason that I am glad to be here today, because I fully understand the influence that you gentlemen have on others and the contribution which you can make to that better understanding.

As a matter of fact, it often occurs to me that those of us who are inside the Federal Reserve System and take its policies and actions for granted would be very much shocked to learn of the real understanding, or, rather, the lack of understanding, of generally well-informed people with respect to the System. It's important from my point of view that the System's policies and actions be understood, because if they are not correctly interpreted by the people who are affected by them, those people are very apt to fly from the extreme of bullishness to bearishness and back again. It seems to me that understanding would lead to more temperate reactions and we are more apt to get the effect that we want. Of course, I wouldn't for a moment even imply that an understanding of Federal Reserve policies and actions would provide a ready solution to all of our problems, because even among those who do really understand Federal Reserve policies and actions there are basic differences of both philosophy and point of view.

For example, there are those who think that the System should attempt to promote the fullest possible economic activity in order to prevent any unemployment whatsoever, even at the risk or the cost of a little inflation and sometimes not such a little amount. Then on the other side there are those who believe that a little depression every now and then is a very good therapeutic purge. Well, the Federal Reserve doesn't hold with either of these extreme beliefs. As a result we find critics on both sides of us--those who are urging us on and those who are urging us toward greater cuts. As a matter of fact, I would be a little shocked if at any particular time we found all of the criticism coming from one side, because that would indicate to me that we had deviated from the golden mean of policy formation.

Now, before I go any further, let me define the terms that I will use. Ordinarily the Federal Reserve System includes the 6,400 commercial banks of this country which are members of the Federal Reserve System and hold 85 percent of the deposits of the country; the

12 Federal Reserve banks and their 24 branches, scattered in 36 of the major cities of the country; the Open Market Committee; the Federal Advisory Council; and the Board of Governors. But for the sake of convenience I'd like to limit that and use "the System" to mean only the Federal Reserve banks and branches, the Open Market Committee, and the Board of Governors.

Taking them up in that order, the Federal Reserve banks and their branches perform very important service functions for this country. They perform services not only for the commercial banks, but for all the people of the country. As you know, when the System was first set up, when the Federal Reserve Act was first adopted, it was primarily designed to perform a service function--to provide an elastic currency and to bring to an end the recurrent financial panics which had beset this country for so many years.

I must say, without boasting at all, that the System has really performed in that respect. It has performed so well, in fact, that today practically no one, except for a few historians, can remember that we ever had financial panics in this country, not caused by weaknesses of credit or by loss of value of assets, but by the sheer inability to obtain currency. Practically all of the currency of this country goes out through the Federal Reserve banks, and it comes back in through the Federal Reserve banks either for reissuance or for destruction. There are approximately $31 billion outstanding today, $27 billion outside of the banks. That amount will vary just before Christmas by a billion dollars, receding during the following months. There are slighter variations during the period preceding and following the Fourth of July and Labor Day.

You might be interested in the fact that these Federal Reserve banks and their 20,000 employees handled enough currency just last year to stack 350 miles high. That's a lot of currency.

Or take the other side of it. Take the clearance of checks. Take your checks and my checks, paying your bills and my bills throughout the whole United States. Most of them are cleared through the Federal Reserve System. So just for the fun of it I ascertained the number of checks which were cleared last year. Then I had one of our statisticians take the average measurement of a check and add them all together to find out how long a check ribbon those checks would make. The ribbon was long enough to wrap all the way around the world, not once but 10 times, and still leave enough over to tie a bowknot the loops and ends of which would festoon the entire State of Texas. Well, that's a real contribution to the economic machine upon which our way of life is based.

Well, let's take one other little service function which almost no one knows anything about. That's the Interdistrict Settlement Fund, operated largely in Washington, through which the vast majority of the financial transactions of the country are cleared daily. Every night every Federal Reserve bank wires in to us the amount of its obligations, and we debit or credit those to the account of the appropriate Federal Reserve bank or branch. Every single day financial transactions amounting to approximately $4 billion are transferred in that manner.

Let's take another curious fact--that of acting as fiscal agent for the Government. The public debt transactions, the issuance of Government securities, the exchange of them, the redemption of them, the payment of them--all those are handled through the Federal Reserve banks. That's a really large amount of work. We act as fiscal agent, for example, for the Post Office Department, with all of its postal money orders, for the Export-Import Bank, the Commodity Credit Corporation, and the like.

Well, one of the other jobs which was imposed upon the Federal Reserve System by the Federal Reserve Act was that of improving bank supervision. This we have attempted to do throughout the years in several ways.

First, we examine all of the State member banks. We review the reports of examination covering all the national banks of the country and thus keep a weather eye out on those. We issue regulations applicable to all member banks throughout the country. We, the Federal Reserve Board, even conduct schools for new assistant examiners and for the old examiners, those who are really experts in their field. This training is not only for our own people, but for those from the national bank examining force of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and to the extent we can do so, for representatives of the State supervisory force. We have those schools going almost continually. In the process we are training better examiners and thus doing a much better job.

All of us know that the Federal Reserve System performs an even more vital function. It is vital from the standpoint of the economic welfare of the people of this country because, first and foremost, the Federal Reserve System is the central bank of the United States. As such it is the lender of last resort, the creator of bank reserves, and the regulator of the volume and supply of money. In short, it formulates and executes monetary policy, one of the most potent forces in the economy.

You may want to know what the monetary policy of the System is. Well, it's very simple. It's merely to provide the economy with all the money and credit it needs, not only for a normal operation, but for healthy growth as well, but not so much as to induce inflation on the one side or to bring about deflation on the other.

We consider our job to be that of the preventing of boom and bust cycles from arising out of money and credit causes, and, to the extent that we are able to do so, to moderate a cyclical movement stemming from any other cause.

Of course, since both inflation and deflation are caused by factors other than the misbehavior of money and credit, we cannot expect too much. We can never keep the economy of this country, or any dynamic economy, on a completely even keel. You can't keep production on a straight upward path, and you can't keep employment that way either. It's completely impracticable.

Our critics expect us to achieve this, but that's merely another reason why we need to have a broader and better understanding of Federal Reserve policy and practice. People should know not only the power which the System wields in the economy, but also the limitations on that power.

For example, we have no control whatsoever over the strongest influence in this economy--the psychological attitude of people. We have no control, and shouldn't have, over the spending habits of people. We have no control, and shouldn't have, over the saving habits of people, the public debt, or the budget. Nor do we have any control over the special pressures brought by industrial, labor, and agricultural groups, which result in price and wage increases, in governmental subsidies, and in grants of one sort or another. All we can do through adjustment of the volume of reserves and adjustment of the money supply is to provide a monetary climate which is conducive to economic stability and growth.

Now, we do this, or attempt to do it, through the institution of fractional reserves. This system of reserves is a very important one. Reserves are not what they used to be, and they are not what many people think they are. I'm free to admit that the whole area of reserve requirements has grown up like Topsy, and as a result there are many inequities which arise out of it.

But the big question is how the reserve requirements affect the cost and the availability of money. The answer revolves around the fact that the volume of reserves determines the amount of money and credit available for the economy. If the volume of current reserves in the entire banking system were exactly equal to the volume of required reserves, the banking system couldn't extend a single loan, make a single extension of credit, because to do so would be to create deposits for which there was no reserve and consequently to create a deficiency. On the other hand, if that volume of reserves were substantially expanded, the banking system could not only make further extentions of credit and purchase securities, but it would probably shave interest rates in order to put idle funds to work, because banks can't afford to have idle funds sitting around not earning their keep. And, if that volume of reserves were reduced, the banking system would have to call in loans, it certainly would be more reluctant to extend additional credit, and it would charge more for what it did. There can be no doubt that a willingness of banks to lend tends to promote economic expansion and their unwillingness to do so has the opposite effect.

So this volume of reserves can be expanded, either at the initiative of the commercial banking system through borrowing from Federal Reserve banks, in which case their accounts are credited with so-called high-powered Federal Reserve dollars; or the Federal Reserve System itself can do it by purchasing Government securities, which we do day by day, paying for them with these high-powered Federal Reserve dollars, which are credited to the account of some bank or other and thus filter down through the entire banking system. They are called high-powered because for every Federal Reserve dollar the banking system can lend or invest about $6.

But, the difficult job is determining what is the right amount of money and credit for our economy. If we have too much money, chasing too few goods, I don't have to tell you that the goods and the money will level off just like a tub of water, the value of that money will go down and we will have inflation. But if you have too little money and too many goods and services available for purchase, then you have that leveling--the value of the goods goes down and the value of the money goes up--and you have deflation. Of course it isn't quite that simple. But the big job remains to determine what is the right amount of money and credit for our economy in order to promote stability and growth. There are no precise yardsticks for determining this.

My youngster, as his brothers did before him, raises tropical fish; and I assume that some of your youngsters do too. If so, you have learned, as I have, through hard experience that the clarity, the beauty, the health of the aquarium depend upon maintaining a proper balance between four factors--water, fish, snails, and vegetation. If you do maintain a proper balance, the water remains as clear as crystal, you don't have to clean the bowl every day, and the fish remain healthy. But if you don't that water turns murky and cloudy and the fish start turning over on their backs.

Well, you can't do anything about the volume of water, because the aquarium is only so large. And, at least in my household, you can't do anything about the number of fish and snails without committing murder. Your children may be different. So that all you can do is to try to provide the proper environment, the proper balance, by either putting some vegetation in or taking some out. And there are no rules to tell you how to do it. If you succeed, you are very lucky.

Now, I sometimes think that there is a slight analogy--and I underline "slight"--between the aquarium and the economy. In both instances you have exactly the same objective--a proper environment, either aqueous or economic. In both cases you have control over only one of a number of factors. In the case of the aquarium you have control over the vegetation; in the case of the economy you have control or influence over the volume of money and credit.

In both cases you have no rules whatsoever which enable you to determine the appropriateness of any given action. But there is one very real difference. When you put plant life into that aquarium, you know that it is going to begin manufacturing oxygen immediately. But when you put more bank reserves in the banking system, whether that results in an expansion of money and credit depends upon psychological forces. You can make money available, but you can't make banks lend it and you can't make people borrow it.

That leads to a very suitable, I think, humility in the Federal Reserve System--a realization that through the best possible formulation of monetary policy you cannot assure economic stability. All you can do, as I said before, is to provide an environment which is conducive to economic stability.

Well, that's the machinery, then, by which we attempt to make a contribution. But, as you know, the best machinery in the world is of very little value, except perhaps as a museum piece, unless it is utilized effectively for the purpose for which it is designed. You can take the most beautiful jet plane in the world and put it down in a clearing in New Guinea; and, while it might receive the awe and the veneration of the untutored natives, it wouldn't serve any real purpose without fuel and oil and a good landing strip and, above all, people who know how to take it off the ground, pilot it, and bring it down again. I think there probably isn't anyone in this room who doesn't agree with me that we have a very fine piece of machinery in the Federal Reserve System. But how does it work?

We raise or lower reserve requirements, we raise or lower discount rates, we engage in open market operations, buying or selling anywhere from $25 to $250 million of Government securities a day. On what basis do we make those decisions? What's the course of our study which enables us to formulate judgments? Do we simply act as the mediums do in trances and wait for an inspiration? Or do we pull down the shades and get out the crystal ball? I am sure that some of you in this room have considered these things before and have perhaps come to even more cynical conclusions.

When I first went with the Board of Governors, I had a fairly good understanding, I thought, of the purposes of the Federal Reserve System and what it did. I had had a bank supervisory background. I was supposed to know something about the banking business. But I didn't have the slightest notion how the System actually operated. And so it occurred to me, as I was jotting down these few notes, that you might be interested in that angle of it and that, if it seemed to me that you were, I'd cover some phases of it.

I suppose that all of us could agree that the really significant part played by the Federal Reserve System relates to the control of the money supply. The Board of Governors participates in all the coordinate functions in that regard. Its members are the majority of the members of the Open Market Committee. It itself must fix reserve requirements within the minimum and maximum fixed by Congress. And discount rates, which are originally fixed by the directors of each particular Federal Reserve bank, must be approved by and, if necessary, determined by the Board of Governors. Since the Board is the segment of the System which has its fingers--I suppose the critics would say "its thumbs"--in every segment of the pie, I shall discuss it further.

The Board is composed of seven men, who are appointed for a 14-year term, each from a different Federal Reserve district, and therefore with a different background. Each member of the Board has exactly the same power as every other member of the Board. One member is selected by the President to be Chairman of the Board of Governors. Therefore he presides at the meetings. He ordinarily serves as the spokesman for the Board. For example, in a congressional hearing he usually testifies, but all members of the Board are called upon from time to time to testify.

We meet every morning at 10 o'clock. They're meeting right now. There are more days when we meet twice a day, that is, morning and afternoon, than there are when we don't meet at all. We do not have formal meetings, like the Supreme Court, for example. We don't wear robes. We don't use Robert's Rules of Procedure. But every person is expected to speak his piece and to participate in every decision that is made.

We operate on the basis of an agenda, which is provided each board member the afternoon before so that he can take it home with him at night. It covers items which have previously been processed by the staff and have been routed through every member of the Board. An item never gets on the agenda until after he has satisfied himself and made up his own mind with respect to what the answer should be. But there's no caucusing whatsoever before meetings. Our decisions are based on the influence of each individual member at that board meeting. And although we argue vehemently with each other during the process of the meeting, once we walk out the door, we stand as a unit. The majority will prevail.

We have at our meetings members of our staff who have worked on particular matters. They are there so they can provide us with additional information if we wish.

At the end of every day there is placed on the desk of each board member a report covering the Government securities market for that day, together with a tabulation of all the facts and all the changes in those facts affecting the national money market. That's a report of only a few pages, but it's the result of a considerable amount of high-speed, high-tension work by a group of especially trained and especially competent economists and market experts.

The next morning, the very first thing, there is on the desk of each member of the Board a much fuller report from the Federal

Reserve Bank of New York, which can truthfully be said to take the pulse of the national money market 24 hours a day, covering not only the status of the Government securities market, but all other securities markets, municipals, corporates, money rates, the actual operation of the System in the money market, foreign exchange, and so on.

And then at more infrequent intervals we receive reports and summaries on such things as the average of member bank reserves; the condition of banks in leading cities; the condition of all banks throughout the country; trends of loans, deposits, and investments; developments in the monetary and credit field in all sectors; gold inflow; gold outflow; and the like.

Then once a week we have what we call an economic roundup. In the board room we have at one end of the room a large screen, on which will be flashed charts covering every sector of the economy. At the same time at the back of the room there are some 10 to 20 of our top economists, who discuss each special sector of the economy in alignment with those charts. So we get a visual presentation and an oral presentation simultaneously.

Those men will discuss such things, for example, as industrial production, construction, employment, distribution, prices, housing credit, banking credit, and all the different phases and subdivisions of each. At the same time on the walls around us in the board room are perhaps a dozen major charts, kept constantly up-to-date--and if and when you come over, any of you, I hope you'll go in the board room and take a look at those charts which, in my own opinion, present the economic situation prevailing in this country more graphically and understandably than any other data of comparable magnitude that I know about.

Well, I've touched on some of the kinds of economic information upon which we base decisions. I have done that merely to emphasize that there is a realization upon the part of the Board that in this particular field intelligence and judgment are of very little value unless they are based on factual information, just as facts are worth very little unless they are analyzed and applied with judgment and courage and integrity. But all these factors, compressed and brought into focus by the comments of our staff, flow in a continuous stream over the desks of and at the meetings of the Board of Governors.

As I indicated before, there is no delegation of authority within the Board. All of us are expected to be completely informed with respect to every decision which comes before and has to be made by the Board. No one member of the Board has the responsibility for any given area. Each person must express his own point of view irrespective of his background before the decision is made, and then it's made on the basis of a majority vote.

But, as you probably can imagine, some of the discussions in the Board are rather heated. At times I would say they are very acrimonious. But I for one do not regret at all the heat, because it indicates, to me at least, that all the members of the Board realize the importance of the decisions they make; that their judgments, whether sound or unsound, have an impact on the lives and welfare of the people in this country unique in magnitude for good or for ill.

Let me turn now to the Open Market Committee. The Open Market Committee is composed of the seven members of the Board of Governors and 5 of the 12 presidents of Federal Reserve banks. We meet every two or three weeks, here in Washington. The attendance at those meetings, which have never been attended by anyone who was not a member of the committee or the staff, consists not only of those five presidents and the seven members of the Board--the voting members--but also of every president of every Federal Reserve bank. They are there at every meeting whether they come from San Francisco or Boston or Texas. It must be a burden on some of those men to come that distance, but we consider this to be extremely important.

In addition to those people, there is the manager of the account, whose situs is New York; and the secretary of the committee, plus a limited number of staff people who have been individually selected. That includes economists and lawyers.

No one who is in that room is permitted to disclose anything that goes on in that room relating to the formulation of policies or what action is to be taken, because it's perfectly obvious that if any individual knew what the policy was to be, it would be very simple for him to engage in security operations, for example, which would be extremely profitable.

Those meetings are presided over by the Chairman of the Board. Again, like the Board, we operate on a very informal basis. No one interrupts anyone else. Each individual is expected to speak his piece, and does. There is no caucusing. There are no formal rules of procedure.

Let's take a typical meeting. The first thing we would do would be to go over the minutes of the last meeting and then the operations of the account during the interim. As I say, the interim means a 2- or 3-week period. When I first went with the Board of Governors, the Open Market Committee met four times a year, with an executive committee operating during the interval. But we changed that about five years ago, so that now the entire committee meets frequently and regularly.

We will go over the operations of the account during the interim for the purpose of seeing whether the actual operations coincide with what was intended at the last meeting. Once we finish that, we have a report on economic conditions prevailing in the country from our economic staff. Then we start around the table.

At Tuesday's meeting--we had a meeting on last Tuesday--we started at one end of the table, each individual speaking his piece. At the next meeting we will start at the other end. At these go-arounds, each president of a Federal Reserve bank gives first of all a review of the economic conditions prevailing in his particular district and the extent to which they vary from the national economic picture. His economic views are ascertained not only through his own eyes, but those of his own economic staff. Then he will set forth what he thinks is the best way to deal with the economic problems which are subject to the influence of the Federal Reserve System. He will state specifically what he thinks the open market account should be doing during the next two or three weeks. When it's gone all the way around and everyone has expressed his view--and I can remember only one or two occasions when there has been a complete unanimity of opinion; there's always a divergence of opinion--when we get all the way around, everyone is free to speak again if he wishes.

Then it's the chairman's job--an unenviable one--to see if he can pull out of that whole discussion what happens to be the majority view, because here again the majority will prevail. And here again, although we may argue, once we walk out the doors, the majority rule prevails and even the minority supports that position. It's the only way in which we can function.

Well, as you can see from that, we get not only a determination of what the open market policies are going to be, but we also have substantial additional economic information which is thrown into the same basket with all the other economic information we have and forms the basis for decision.

It's obvious that there must be some way in which to keep abreast of actual operations in between meetings. We do that through a telephone hookup. Every day at 11 a.m. and 4 p.m. we have a telephone hookup between the manager of the account in New York, the Board of Governors, and one other Federal Reserve bank, selected on a rotating basis, in which we ascertain the tone of the market, the feel of the market, what the conditions are that are prevailing, what the proposed actions are, and what the actual actions were.

Next, let's take the Federal Advisory Council. It's a statutory body, composed of 12 men--for as long as I know, they have all been bankers--each of whom is elected by the Board of Directors of a Federal Reserve bank. They meet with us four times a year. They come here on a Sunday, meet among themselves, and formulate their responses to specific questions which we have submitted to them. On the next day, on Monday, they meet with our economic staff and get a picture of the national economy as our staff sees it.

On Tuesday they meet with the Board, at meetings which are attended by no one except the members of the Advisory Council and the Board of Governors, plus a secretary. At those meetings they give us the benefit of their views. We do not tell the Federal Advisory Council what our views are or what we propose to do. We seek from them their views with respect to our past actions and any legislative matters that are brought up. We do it with the idea of getting--and we get--criticism of past actions, because we can benefit from criticism.

If there is a disparity of view as between the members of the Federal Advisory Council, we go around the table and get the views of each one of the 12, so that we can see who is on which side and why.

In addition, we get from each one of the 12 his views with respect to the economic conditions prevailing in his district; and that adds to this great mass of information upon which we operate.

Well, that's the way in which the System tries to make its contribution to a stable and growing and healthy economy. I am aware that I haven't covered anywhere near all aspects of the System. I have not touched on bank supervision, how we administer the Bank Holding

Company Act, or how we maintain working relationships with the Treasury Department, the Comptroller of the Currency, the FDIC, or the Congress.

Let me conclude by saying that even as important--and I may be very biased on this--as the Federal Reserve System is to the economic welfare of this country during normal peacetime, it has even greater responsibility during wartime. It's no secret that in wartime, tax receipts do not keep up with expenditures. Therefore the responsibility is thrown on the Federal Reserve System to facilitate the operations of the Treasury Department in financing the deficit. I sincerely hope that if we ever go through another emergency, we will profit from the experience and the mistakes of both World War I and World War II.

Just a word with respect to defense planning, in which I assume some, perhaps all of you, are interested. As you may know, the Board of Governors is represented on the Defense Mobilization Board, on the Emergency Resources Board, and on many of the committees working with ODM in planning in this area. We have, as you certainly know, set up relocation sites not only for the Board of Governors, but for each of the Federal Reserve banks and branches, which are fully equipped not only with machines but with information on which the survivors could function. We train people in functions they never have dealt with before.

Then in addition we have done some planning, pursuant to authority delegated to us by the ODM, first, relating to leadership in bringing about preparedness programs by the commercial banks of this country. To that end we have established committees of leading bankers in the country and leading operating officers of commercial banks. They have drafted a manual for distribution to all commercial banks. I'll say no more about that, because I understand you're going to hear from Ed Cooper, who is chairman of this committee, in the near future, and who has done a marvelous job. The first pamphlets will go out to the commercial banks very shortly.

Secondly, we have attempted to work out ways and means of enabling the financial system of the country to deal with the demands which will be made upon it in the event of an attack, relating both to general credit controls and to selected controls. We have the responsibility of working with the Treasury and the Comptroller of the Currency and the FDIC in devising ways and means of keeping the commercial banking system operating, for providing a continuous flow of deposit money, checkbook money, which is just as important as and even more important than currency, and for providing for actual currency and appropriate bank credit.

But to me, even more important than that, we have been charged with the responsibility of presenting ideas to ODM with respect to other factors which would have to be dealt with if our economy is to survive. That covers such things, for example, as indemnification of losses, moratoria, rationing, and allocation of materials. Those are matters on which we do not make the decision. Those are matters on which we only submit ideas, and we have no illusions that the ideas we submit are necessarily the right ones. They are as good as we can make them at the moment.

In the course of our planning we have operated on the assumption that no matter how much devastation would come from a war with modern weapons, there would still be some areas of the country in which the economy had not been affected or in which the economy could be quickly rehabilitated. It is to those areas that we must look for the survival of our economy and the survival of our country.

We have also assumed that in the event of attack the Government itself will be badly disrupted, that it will be impossible for the entire country to be operated from a central point, and that therefore you must rely to the fullest possible extent on individual private initiative, operating in accordance with previously provided guidelines, leaving government--central, regional, and local--to do what only government can do. For these reasons we think it is vitally important that we study the past and prepare for the future and try to devise a financial system that will enable our economy to function, in order that this country can win the war and survive.

Our planning has not been, as I am sure all of yours has not been, solely for survival, but really for a way of life. It may even be that the planning all of us do is really for life itself. This planning job isn't a pleasant one. It's rather frightening, as you know better than I; and it isn't a one-shot job. I doubt if any of you or any of those who have engaged in planning really think that the planning we do will exactly fit the needs of the situation. But it will certainly be a lot better than requiring survivors to start from scratch.

The job is a thankless one, because I know that all of us sincerely hope that the products of any such planning will never have to be put to use. But it's one that we have to do. From the point of view of the Federal Reserve, if we can do our part of it well enough to effectively contribute to the kind of planning that will forestall a nuclear attack, we think it will be most rewarding and most worth while.

COLONEL WALKER: Governor Robertson is ready for your questions.

QUESTION: It has been evident to us from a number of the economists who have spoken to us here that many of them have diverse opinions on what is wrong with the economy. There have been articles cited to us in the class indicating that the economic cycle goes on whether the political environment is Democratic or Republican. I wonder if you would review for us the political orientation of the Board and, if it is pertinent, of the Open Market Committee, and comment on what influence that political alignment may have on your actions.

GOVERNOR ROBERTSON: I would be very glad to, and I can do it very shortly.

The Board is completely nonpolitical. We recognize no pressures. Fortunately, we have established a position within Government so that it is realized, both from the executive side and on the congressional side, that we are not subject to influence. That's true with respect to the Open Market Committee. It's true with respect to the Board of Governors. During my term on the Board I have never seen political influence felt or reflected by board action.

QUESTION: It seems to me that one of the strongest factors affecting the psychology of the consumer is the amount of down payment that he has to make in installment buying. I wonder if that is a useful tool by which to exert influence on the economy on the part of the Federal Reserve.

GOVERNOR ROBERTSON: Selective controls, in my own opinion, are bad, because they merely postpone demand. Once you take them off, you have a tremendous rush, which throws everything off balance.

It is true, that consumer buying on an installment basis does intensify the demand for goods. It grows. It's still growing. But if you attempt to put, say, a Regulation W into effect at this time, you don't really curtail desire. You curtail the right to buy. If you make general credit controls restrictive enough, you will make it impossible for people to get the kind of money which will enable them to buy, because you make it more costly for the finance companies to get their funds with which to lend, and much more costly for the retail stores, for example, to borrow money to build up inventory or to carry the stock.

I am personally against selective controls. I think we can deal with the consumer credit problems through general credit controls. I think consumer credit is responsive to general credit controls.

QUESTION: This morning the fact sheet that was put out in connection with the economic report included the President's statement concerning the economy. I am curious to know to what extent the Federal Reserve Board participates in the formulation of such fact sheets, and whether a statement like that represents the views of the Federal Reserve Board or whether they have any influence on it.

GOVERNOR ROBERTSON: That fact sheet does not originate in the Federal Reserve. It does not represent the Federal Reserve's views. They may coincide, but this isn't the way we ever put out views.

We do provide to the President's Council of Economic Advisers the results of economic studies which we make. When we formulate our own views with respect to what the status of certain factors is in the economy, we make that available on a regular basis to the Council of Economic Advisers. They formulate their own decisions as to how they want to interpret it or as to what action they want to take. We do too. They don't try to tell us how. Never do they try to tell us how, nor what we should do; and we don't tell them.

Now, there is one little angle that I should refer to and that is that recently the President has set up meetings, which are attended by the Secretary of the Treasury, the Director of the Budget, the Chairman of the President's Council of Economic Advisers, the Chairman of the Board of Governors and the President's Special Assistant for Economic Affairs. The purpose is to provide the President with any economic information they have. At those meetings the Chairman of the Board of Governors would certainly state what his views are, but his views are just one of seven views of the Board of Governors; and he would never attempt to bind the Board. No governor can ever do that.

Consequently, the views which are formulated at the White House or by the Council of Economic Advisers may coincide with our own views, but they don't speak for us. We let our actions speak for themselves. Otherwise we would spend all of our time interpreting interpretations on interpretations.

QUESTION: Would you care to comment on the relationship of the Federal Reserve Board to the Department of the Treasury in problems relative to their respective missions?

GOVERNOR ROBERTSON: I'd be very glad to.

There is no question about the need for very close relationships between the Treasury and the Federal Reserve, between fiscal operations and monetary operations. As a result, we try to work closely together, in that we keep each other informed with respect to our operations.

Every Monday, the Chairman of the Board of Governors has lunch with the Secretary of the Treasury, and on every Wednesday the Under Secretary of the Treasury and their staff people come over and have lunch with two representatives of the Board and members of our staff, for the purpose of letting each side understand what the problems are on the other side.

We have no reluctance in telling the Treasury what our problems are, or in listening to their recitation of their problems. If they ask our advice, we give it freely. But under no circumstances would we tell them what they should do, or would they think of telling us what we should do. It's a very fine working relationship, each realizing that the other agency must make its own decisions.

QUESTION: In your postattack planning what measures do you envisage to instill confidence of the survivors in both the currency and the checks that may be available to large numbers of people?

GOVERNOR ROBERTSON: That's a very difficult problem, because we don't know what factors are going to affect people or how they are going to react. But what we can do is to see that there is enough currency placed around the country, which we can get at and make available, so that there never can be a fear that there won't be enough to take care of the requirements. We've built up supplies over the past five years, additional supplies of currency, for what we think will carry us for a 1-year period, of ones, fives, tens, twenties, and so forth. They are put in spots from which we think they will be accessible in the case of need.

With respect to checkbook money, that provides a real problem which hasn't been settled. From the point of view of the Federal Reserve, if something were to happen this minute, and if I were the person who were put in charge, the Federal Reserve would honor every check drawn on any bank in this country, whether it was at the bottom of a rubble heap or not. That would be far better than a stoppage of the flow of checkbook money.

Of course you have to realize that wherever a bank is destroyed, many of its customers, its depositors, will also be destroyed. There may be someone, however, out in Broken Bow, Nebraska, who has a deposit in the Chase--I can't believe that--or some other bank; and if he drew a check, it seems to me that that check, if we're going to maintain the sort of confidence which is necessary, must be honored. And so in the Alert we've taken the bull by the horns and we've honored every single one of those checks. The theory behind that is that by so doing you make reserves so available that the Government can finance the checks solely out of Federal Reserve funds with no difficulty whatsoever.

QUESTION: Have your operations on the rediscount rate and the open market had the predicted effect?

GOVERNOR ROBERTSON: I think there can be no doubt that the lowering of the discount rate and the providing of reserves through open market operations have eased credit conditions considerably. We have had the biggest, the most drastic, drop in rates on Government securities in the shortest time in history. That in itself eases conditions so that municipalities are now coming to the market with their issues and raising money for the purpose of building schools and hospitals and the like. Yes, I think the effect has been good.

Now, as I indicated earlier, there are those who think we haven't done enough, and there are those who think we've done too much. There are those who think that part of this present psychological attitude stems from the fact that we did reduce discount rates and thus confirmed fears of a depression.

Well, who's right? We can't go back and do it over again. We have to start from here.

QUESTION: You partly answered my question in your last answer, but perhaps we can get at it from a different angle. It has not been very many months ago that the President was very much worried about inflation. Now he is worried about deflation. When he was worrying about inflation, there was an increase in the discount rate. Now there is a decrease in the discount rate. My question is this: Don't you think that the action of the Federal Reserve Board came a little bit too late and was perhaps a little bit too limited to stop that inflation; that you could have stopped the inflation a little bit earlier, because we are now worrying about deflation, which may be coming about anyway?

GOVERNOR ROBERTSON: Hindsight is a wonderful thing. You can see, looking back, just exactly where you should have acted and when. But looking ahead now, it's a little more difficult. If I were the exclusive personification of the Federal Reserve System and I were looking ahead to see what to do, I would see a large amount of unemployment. I would see a drop in the index of industrial production. I would see a drop in the gross national product. I would wonder: "What can I do?"

Then I'd turn around and look at some other figures. I'd see that retail prices are staying right up there. I'd see that even though you have this large amount of unemployment, it's a very different picture from what it used to be. Unemployment then meant that if you were unemployed, you were unemployed--you didn't have any money coming in. But if you are unemployed now, 60 percent of your salary is paid to you in the form of unemployment compensation. So that if I'm unemployed, I still am in a position to buy; maybe not as much, but I can buy. Therefore the effects of the unemployment are not as great on the economy as they were then, although they are bad.

Then I would see that we have this tremendous expansion of productive capacity which resulted from the plant and equipment spending, and that we have to have an increase in the demand before we can get that started back up again. And I would puzzle some little bit before I would decide which way I should go.

Now, the reason I'd puzzle is this: If I were to throw lots of money into the credit stream and thus stimulate everything, what is going to happen? Well, we would have a lot more money, and we would have an upsurge of inflation. So what do I do? I leave that for you to answer.

QUESTION: Somebody said that he thought a certain amount of long-term inflation is good rather than bad. Do you support that view?

GOVERNOR ROBERTSON: It depends on the will of the people of the country. From my own point of view I don't think long-term inflation is essential. I think if we have the courage to do so, we can prevent it.

There are a lot of people in this country who believe that we're sort of a weak-kneed outfit, always wanting to stop inflation but fearing deflation much more. They believe that, if you start downhill, --even a little bit--we should do something drastic immediately. That would result in putting a floor under each inflationary rise. But if you are going to have stability, if you are going to maintain the buying power of the dollar in a dynamic economy like ours, you have to expect "ups," but you also have to expect some "downs," and not get too excited about them. If you don't, you're always going to have "ups." There are lots of people--some of them may be on the Federal Reserve Board some day--who are more fearful of deflation than they are of inflation. And if that's so, they will move to offset deflationary movements much faster than they will inflationary movements, and so you will be going continuously up.

My personal view is that we didn't move fast enough, hard enough, when the economy was on the uptrend. We should have been tougher. But we didn't do that. We did it to a very considerable extent, much more so than people had a right to expect; and I don't mean to belittle the action that was taken. But from hindsight I don't think it was enough. There were times when we took action which called for courage. The action was taken. Maybe we couldn't have gone any further. I personally think we could.

QUESTION: My question has to do with all types of controls. It seems that we are leery about imposing them because of what the general public's reaction might be. I suppose, as you suggested, if there ever is an attack on this country, the whole tenor of public opinion is going to change and that controls are going to be necessary and needed. I think that this country will become more confiscatory-minded; that people will accept confiscatory actions; that they will become more like the Europeans, who have been subjected to war actions for a long time. Why today can't we in our preattack planning feel this coming on and plan for all types of controls? Why do we have to live in the past and have the people who are responsible for imposing controls worry about what the general public's reaction is going to be? I know this is not particularly in your field, but--

GOVERNOR ROBERTSON: Oh, yes, it is.

QUESTION: Would you give us your views on that?

GOVERNOR ROBERTSON: I'd be very glad to.

In the first place, I agree with you that in times of war we are going to have to have selective controls. We have completed and fully drawn plans for wartime controls in selected areas with respect to things like consumer credit, for example, and housing credit. But they would not be enough in an emergency. In that kind of a situation you need rationing as well, because you can't just have selective credit controls on the one side and expect them to work. You have to have rationing. You have to have allocation of materials.

QUESTION: I wonder if you would clarify the status of the Federal Reserve banks as to whether they are wholly private institutions, Government institutions, or quasi-Government institutions. I might say that my confusion has been aided and abetted somewhat by Congressman Patman's recent remarks with respect specifically to those banks.

GOVERNOR ROBERTSON: I'd be very glad to. Of course you realize that when I do it, I am stating my own views and not those of anyone else.

The Federal Reserve banks are quasi-public instrumentalities. They are not owned by the commercial banks of this country. They are owned by the people of these United States. They perform public functions.

But we have utilized a very ingenious device for keeping those institutions from being one-sided by bringing into them the intelligence and the judgment of people in private life. We do that through the boards of directors. Each board consists of nine directors, as you know. Three of them are appointed by the Board of Governors, and they represent the public sector. Three of them are bankers, and they represent the banking sector. Three are elected by the bankers, but they are nonbankers, who represent the buying public. Those boards of directors bring to those Federal Reserve banks some of the real benefits that you get from outside points of view. There are some 250 of these directors, and I must say they represent the leading citizens of this country and perform a very real public service.

The disclosures which Mr. Patman has made in the past few days, and which seem to have received a considerable amount of publicity, are misleading. This information that he has is not information that he has dug up. It is information we have furnished him.

We examine all the Federal Reserve banks and their branches through a staff of examiners. Not only that, but we employ outstanding firms of public auditors to supervise one of our examinations each year and audit it for the purpose of seeing whether we are doing the best possible job and whether we are using the best possible procedures. The information which we get comes in to us. We do not hide it from any congressional committee. We give it to them.

For example, one of the items cited was that the Federal Reserve System, or some bank, had paid an honorarium of $2,000 to someone to come and make a speech; $1,600 to four others, $1,500 to three others, and $500 to one other, or something like that. What are the facts?

About a year ago the Joint Economic Committee of Congress, of which Mr. Patman is chairman, the Council of Economic Advisers, and the President of the United States asked the Federal Reserve Board to make a study of small business credit. So we launched that study. In the course of it we engaged eight or nine of the top economists of this country, who spent a considerable portion of their time from January to September preparing papers on various segments of this study. Then at the end of that time they all met together in a 2-day session.

The fees they were paid were the $2,000, the $1,600 and the $1,500. Now, that is not $2,000 for making a speech. We are paying them for the work they did over a long period of time and the papers they presented, which were published in our completed volumes that were then presented to the Committee.

Other items cited were similarly misleading.

QUESTION: You have already answered one of my questions, which was whether or not your institution has actually insulated itself to some extent from any form of public opinion. My second question, however, is this: In retrospect would you indicate what, in your opinion, were the three most important factors contributing to our inflation of the past 10 years?

GOVERNOR ROBERTSON: No. Not because I wouldn't like to, but because I can't.

What makes inflation? Well, it isn't solely the volume of money that's actually in existence, but it's the turnover of that money. If you take so much money and turn it over 25 times, it's that big. If you turn it over 100 times, it's much larger. So that the volume of money you have chasing the available goods and services is much greater and you're going to have a leveling off and you're going to have inflation. That is dependent, then, upon the psychological attitude of the people.

I wouldn't want to point a finger at the consumer or at labor or at industry. I think it's a conglomeration of the whole economy. We outbuilt our productive capacity because of the tremendous upswing of capital goods expenditures. We built a capacity which was greater than the demand. You have to let that settle down until the demand catches up with it.

COLONEL WALKER: By the show of hands and the interest, I can see that most of us could keep you here for several hours more. But I happen to know that you have a luncheon ehgagement. So on behalf of the Commandant and the student body and all of us, I wish to thank you very much for a highly informative presentation on this subject, which we need to know more about to do our jobs better here. Thank you very much.

(9 Jun 1958--4, 100)B/mga:bbn