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FEDERAL RESERVE SYSTEM OPERATIONS AT THE POLICY LEVEL

Honorable James L. Robertson

Reviewed by: Colonel Tom W. Sills, USA

Date: 7 March 1960

INDUSTRIAL COLLEGE OF THE ARMED FORCES

WASHINGTON, D. C.

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Reporter: Grace R. O'Toole

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GENERAL HOUSEMAN: This week we have had some economic prognostications, information on price-wage relationships, information on the Treasury Department, and other economic discussions. In these discussions the facts have been brought out that the Federal Reserve System has some importance or value in this whole economic picture.

Last September you received information on the Federal Reserve System, its functioning, and its organization. Now we are going to have a specific talk again on the subject of the general problem of policy within the Federal Reserve System.

We have a speaker here this morning who has been on the Board since 1952 and is well versed on the subject of the Federal Reserve System.

At this time I would like to introduce Governor James L. Robertson of the Federal Reserve System. Mr. Robertson.

MR. ROBERTSON: General, Gentlemen: Just in case I should falter during the next hour or so, I probably should tell you the probable cause. The day after I put on the uniform of a Lieutenant J. G. in the Navy back in the early forties, at a time when I had no training whatsoever and I didn't know how to salute, I was called into Mr. Forrestal's office and asked to attend a meeting of the Heads of two of the Navy bureaus, to see if

I could find a solution for a dispute that was going on between them. He told me, but I didn't realize what he was really saying, that perhaps, in view of my rank, or rather the lack of it, I should be accompanied by a civilian, and one of his assistants would go with me. We walked into the room and it was filled with gold braid. For an hour or so I tried to find what was generating all the heat. At the end of that time I said that I had everything that I needed. I thanked them, shook hands, and took my leave, just as I would have done two days before, as Counsel to the Comptroller of the Currency in the meeting of quarreling bankers.

Before I had even an opportunity to throw a report together, in fact the very next morning, I was again called into Mr. Forrestal's office and told that I had been charged with several serious violations. In the first place I had failed to salute and to stand at attention until told to take a seat. But, even worse, I, a Lieutenant, J. G., had terminated the meeting and had even offered to shake hands with my superior officers.

I am sure that all of you can appreciate why I have a very distinct case of inferiority complex in the presence of so many of you officers. Even so, I am delighted to have a chance to come over and meet with you, as I was with your predecessors last year, and their predecessors the year before, for two what are to me very good reasons. In the first place I have a profound admiration and respect for this school and am only too glad to make whatever contribution I can. Whatever contribution I make will depend very much on what questions you ask. Secondly, I think you men are in a very good position to do what I think is important, to make a real contribution toward bringing about a wider public understanding of the Federal Reserve System.

I rather suspect that most people in this country have heard about the Federal Reserve System, good or bad. But sometimes I wonder if those of us who are in the system wouldn't be just a little bit shocked if we were to learn what the real understanding, or rather lack of it, is of the man on the street with respect to the system.

I am always impressed with the fact that today there are still some bankers in this country, of all people, who believe that the system supports itself by using their banks' reserves to invest in government securities. And so they argue that the profits ought to be divvied up among the member banks. This probably results from the fact that we do have a fairly sizable portfolio of government securities, about $26 billion worth. The profits on those are sufficient not only to pay all of the System's expenses throughout the country but enable us to turn back to the Treasury hundreds of millions of dollars each year. This past year it was around $900 million. Those bankers are very reluctant to believe—as a matter of fact I don't think they do believe--that it would be literally impossible for the Federal Reserve System to use a single dollar of a member bank's reserves for any purpose. We simply can't do it, because we create dollars every time we make an investment, and we cancel dollars every time we pull reserves in. We deal in high-power dollars and not ordinary dollars.

And these same bankers simply won't believe that, if the law permitted us to do so, we could turn back to every member bank in this country the entire amount of its reserves and not even touch a single government bond in our portfolio.

It is perfectly obvious that, unless people understand the Federal Reserve System, its policies can't be fully effective. If people don't understand the moves which we make they are apt to jump from one extreme to another, from bullishness to bearishness, or vice versa, and that really makes the formulation and execution of monetary policy more difficult. Of course I wouldn't have you think that I think that a mere understanding of the Federal Reserve System would solve all of our problems. There are wide disparities of view, wide disparities of economic and political philosophy, among those who understand it very well. There are those who think that it is our duty to stimulate the economy to the fullest possible extent, even at the expense of a little inflation. They don't worry about it. On the other side there are those who think that a depression every once in a while is a pretty good therapeutic purge.

We don't hold with either group, of course. As a result, we have criticism coming at us from both sides, those who are spurring us ahead and those who urge even greater caution. As a matter of fact, I would be just a little disturbed if at any time we found all the criticism coming from one side. It never happens, so I am not very much disturbed. But I might just say that, if you want to be popular, you don't want any place in the Federal Reserve System, because what we do doesn't result in popularity. We are always stepping on somebody's toes.

Let's take a look at the Federal Reserve System. There are 6200 member banks holding approximately 85 percent of the demand deposits of all the commercial banks in the country; 12 federal reserve banks with their 24 branches scattered in all the major cities of the country; the Board of Governors here; the Federal Open Market Committee; and the Federal Advisory Council.

Before I do that, perhaps we ought to just start even by eliminating some of the areas that all of us know equally well. First, I expect all of us know that the system was originally set up as a service institution, designed to provide the country with a more elastic currency, and to put to an end the money banks which had beset the country from time to time over the years. I think in this respect there is pretty general agreement throughout the country that the System has been a tremendous success.

All the money of the country, the currency, for example, $31 billion or $32 billion of it, which increases by about a billion dollars during the two months preceding the end of the year and falls back during the month following that--and there are other fluctuations around the Fourth of July and Labor Day--goes out into circulation through the federal reserve banks to commercial banks and out to the public, and it comes back the same way to the federal reserve banks for either destruction or reissue.

The amount of currency actually handled by these federal reserve banks each year is astounding. If you would stack it up in a pile it would go up 350 miles in the sky. That's a lot of currency. It isn't all one-dollar bills, either.

But I don't think I need to paint any picture of this volume of currency that we handle or even the volume of checks that we clear, which number into the billions, other than to say that these services by themselves constitute no small contribution to the smooth functioning of the economy on which our way of life is based.

As a part of these service functions, and one factor that is little known, the Board here in Washington maintains an inter-district settlement fund through which a very large part of the financial transactions of this country are settled every day. At the end of each day, every federal reserve bank wires into the Board the amount which it owes to every other federal reserve bank or branch, and through those debits and credits we clear approximately $4 billion of financial transactions every day.

Of course, the Federal Reserve also, in the service functions, functions that approximately 95 percent of our 20,000 employees are devoting full time to, include services for the Treasury, like the issuance and redemption of government securities and exchange securities, the handling of their tax and loan accounts in commercial banks, through which the taxes are received and payments for securities are received. It also performs fiscal functions for the Commodity Credit Corporation, the Post Office Department, with all their money orders, and other government agencies. And then, of course, there is another function which was imposed on the Federal Reserve, and that was to improve bank supervision. This we have attempted to do, not only through the examination of member banks throughout the country but also through the issuance of regulations covering all member banks, State and national, for example in the trust field. In addition, we have set up a school, which is a sort of pet of mine, because I had a part in its creation. It is a joint venture with the Comptroller of the Currency in the FTIC. This school is divided into two sections. We take the new men, the green men, who are just coming on the examining forces of any of the federal agencies and State agencies. Then we have a senior school for those who have been on the force and are ready for commissions as full-fledged examiners, and we put them through this course here in Washington. In connection with it, you might be interested to know that we have a little bank set up, which is a perfect little institution, with one exception--it has no money. We have these men examine this bank as they would if they were out in the field. They go through in small groups. Then they have to appear before a Board of Directors composed of our own people. Of course the Board of Directors knows what the records of this bank look like. They have jimmied them to suit their own purposes. We have lots of fun with those students. Well, we put about 1200 men through that course in the last eight years. By this procedure we undoubtedly improve bank supervision.

Of course, the faster we train these men the faster we lose them to the commercial banks, too. But also, the faster the commercial banks become better manned. So it works out to our advantage.

As you know, we have an even more vital function, because we are the central bank of the Nation. As such we are the lender of last resort. We are the creator of bank reserves. And we regulate the money supply. This includes not only, as you know, the currency of the country but the big part of the money supply--the check book money. It's about 80 percent. In short, what we do is to formulate and execute monetary policy.

What is monetary policy? What is our present monetary policy? Well, it's exactly the same as it was last year and the year before and the year before that. It is simply to make available all the money and credit that's needed by the economy, not only for normal operations but also for healthy growth--not so much as to bring about inflation on the one side or deflation on the other side. In other words, it is our aim to see to it that boom and bust cycles do not arise out of money and credit causes and to moderate to the extent that we are able to do so--and our powers are limited--any cycle looming or stemming from any other cause. Of course, as you know, inflation and deflation have causes other than the misbehavior of money and credit. So we can never achieve perfection. Our critics, and we have plenty of them, expect perfection, but that's merely another reason why we need a wider public understanding of monetary policy.

This formulation of monetary policy is a difficult task. I don't mean to imply that through it we can solve all of the problems of this country--economic problems. I think monetary policy is a very powerful influence, one of the most powerful in the economy. But it is perfectly obvious to anybody that we cannot control such potent factors as public psychology, as the spending habits of people, as the savings habits of people, as the public debt, and the budget, or even the pressures from labor, agriculture, and industry groups that result in rising wages and in governmental subsidies and guaranties of one sort or another.

All the Federal Reserve can do is to attempt to promote money and credit conditions which are conducive to economic stability. It can only bring its influence to bear on the economic situation as that situation is created by the actions of businesses, labor unions, agriculture, consumers, and governments. It exercises that influence by virtue of the institution of fractional reserve requirements.

As you know, every bank is required to carry a certain amount of its deposits in the form of reserves. If it is a member bank, it has to carry those on deposit with the federal reserve banks. If the reserves of all member banks, all banks in the country, were exactly equal to the required reserves, they couldn't make any more loans, because that would create more deposits for which there would be no reserves. On the other hand, if they have excess reserves, they are more than willing to make loans, they are anxious to make loans and extend new credit, even if they have to shave interest rates in order to do it. And this, of course, stimulates business activity. On the other hand, if they have a defiency of reserves they are much more reluctant to extend credit. They will even call loans, and they will charge more for whatever loans are made. This tends to dampen down undue expansion and speculative tendencies, by putting a crimp in the plans of those who propose to borrow for those purposes. But the real job, I would say, is determining what is the right amount of money and credit for the economy.

Ordinarily, as you know, if you have too much money chasing after the goods and services that are available for purchase, you have inflation. If you have too little money, you have deflation. It isn't quite as simple as that, but you can see that the real job is determining what is exactly the right amount.

I often like to use an illustration that to me pictures this, and that is an illustration based on an experience of mine which I am sure that all of you have shared. My children from time to time have engaged in raising tropical fish, and we've learned that the health and the beauty and the clarity of the aquarium are dependent upon the maintenance of a proper balance among four factors--water, fish, scavengers (snails or catfish), and the plant life. You can't do anything at all about three of those factors. You can't do anything about the water because the aquarium, at least in my house, is just so large. You fill it up and that's as far as you can go. You can't do anything about the fish or the snails without committing murder, and my kids, at least, won't permit me to do that. So what you try to do is to maintain the proper balance by varying the amount of vegetation, the plant life, that you have in that aquarium. If you happen to hit it on the nose, that water remains clear and the fish are healthy; but if you miss, as all of you know, that water begins turning cloudy and the fish start turning over on their backs.

I think there is a slight similarity between the aquarium and the economy. In both cases you control only one of many factors. In the aquarium you control the plant life and in the business world you extend the federal reserve influences over the money.supply. In both cases the objective is exactly the same—to get a healthy environment--and in both cases there are no precise rules which will enable you to determine what the reaction will be from a given act. In both cases the interference should be kept at a minimum.

Of course there is one very big difference, at least one. When you put plant life, more of it, into that aquarium, you know that it will immediately begin to manufacture oxygen, but, when you put more reserves into the banking system, whether that results in expanding the money supply depends entirely upon psychological attitudes. You can make money available but you can't make bankers lend it, you can't make people borrow it, and you shouldn't be able to.

I think this leads to a very suitable humility in the Federal Reserve System, the realization that all we can do through adjustments of the reserves is to promote conditions which are, as I say, conducive to stability and growth.

Well, that's the mechanism, based on the institution of fractional reserve requirements, by which the Federal Reserve attempts to make its contribution to an economy that is at once stable and growing. Of course the finest piece of machinery is of very little value, except perhaps as a museum piece, unless it is used effectively for the purpose for which it was designed. You can take a jet plane and put it down in a clearing in New Guinea, and it would receive the awe and veneration of the untutored natives there, but it wouldn't serve any other purpose, in the absence of fuel and lubrication, an appropriate landing strip, and, above all, someone who knows how to take it off the ground and pilot it and bring it down again. We have a very fine piece of machinery in the Federal Reserve System. But, how does it work? How does it function as the central bank in the leading industrial nation of the world?

Discount rates are raised or lowered, reserve requirements are increased or decreased, through open-market operations we either provide reserves through buying government securities or we absorb reserves through selling government securities, and we do it by the millions. But how do we make those decisions? Like the Deity in "Green Pastures," do we simply rear back and pass a miracle, or do we pull down the shades and get out the crystal balls? I suspect that each one of you has thought about these things from time to time and you have probably come to even more cynical conclusions.

When I first went over to the Board, I, like you, had a fairly good idea of what the Federal Reserve System was supposed to do and how it went about it. That is, I could see the result of its actions. But I didn't have the slightest notion of how it actually performed. So I thought you might be interested in that side of it. I think we can all agree that the significant place of the Federal Reserve System in the economy of this country revolves around its function as the regulator of the money supply. The Board here in Washington participates in each of the three major areas--the discount rates, the reserve requirements, and the open-market operations. The discount rates, of course, as you know, are fixed by the Board of Directors of the 12 federal reserve banks, but they must be reviewed and determined, and, if necessary, initiated, by the Board here. On the Open Market Committee the Board of Governors represent seven-twelfths of the committee, so they participate there. With respect to reserve requirements, they can be changed only by the Board of Governors. Since the Board is the unit of the system that has its fingers--and I am sure I know at least one critic who would say its thumbs--in every segment of the system pie, I should discuss it first.

The Board is composed, as you know, of seven governors, each one appointed by the President, with the approval of the Senate, for a 14-year term, or the unexpired portion of a 14-year term. If he serves a full term he can't be reappointed. Each must come from a different Federal Reserve District, so we have different geographical backgrounds. Each of the governors has exactly the same power as every other one. He doesn't represent a single district; he represents the entire Nation. One of those seven is selected by the President, with no requirement for Senate approval, to be Chairman of the Federal Reserve, and another is Vice Chairman. The Chairman presides at our meetings, and is ordinarily our official spokesman.

I don't think you can get much of an idea about the Board of Governors without knowing a little something about the members of the Board. Although I know one shouldn't, outside of a closed meeting like this, discuss his associates, I think it is important to see the difference in the background of the people who sit on this Board. I think it makes a big difference. Let me just run through them briefly.

We'll start with the Chairman, William McChesney Martin. I suspect that everybody know that he was born a little more than a half-century ago in St. Louis. For the last half of that period he has called New York his home. In the really troublesome days in the thirties he was President of the New York Stock Exchange. After the War he was President of the Export-Import Bank, and Assistant Secretary of the Treasury. He has been on the Board since 1951. By training, by intellect, by judgment, and, above all, by patience, he is admirably suited for the job as Chairman of the Board.

Going down, the next one would be Governor Szymczak, from Illinois. He's an accountant by profession. At the time of his appointment he was a college professor and a city official, of Chicago. He has served longer than any other man in history. He has served over half of the lifetime of the Federal Reserve System. He came in before the terms were limited to 14 years. I can't imagine anyone who would be more generous than Governor Szymczak in sharing his long experience with his associates.

The next one in line of seniority would be Governor Mills, who spent his entire adult life as a commercial banker in Portland, Oregon. He knows the banking business extremely well and, since we are dealing with bankers every day, it is desirable to have that point of view on this Board. He is a studious, industrious person, who probably works harder than any other member of the Board.

I would come next in line of seniority. You know my background very well, and I suppose you know that I hail from Broken Bow, Nebraska.

The next one would be Governor Canby Balderston, who, at the time of his appointment, was Dean of the Portland School of Finance, University of Pennsylvania. It is hard to imagine a better background for our sort of work. He's an economist and is certainly a great asset to the Board in analyzing economic data. He makes a very real contribution.

The next would be Governor Shepardson, who, at the time of his appointment, was an agricultural economist, Dean of the School of Agriculture at Texas A & M. He brings to the Board an understanding of agricultural economics which is extremely valuable. On top of that, he is a hard-headed, careful thinker, slow in reaching his positions, but steadfast when he gets there. I think he is one of the really able men.

The last would be Governor King, who was just confirmed Monday, I think it was, of this week, for a 14-year term, after having served one year of the unexpired portion of a preceding term. He is young, energetic. He was a successful business man in the lumber business and also was a cattle raiser. He brings to the Board a fresh point of view and helps to keep us from getting into a rut of precedent and tradition. It is a very easy thing, in this little marble palace we have down here, to get completely isolated, and also insulated. You can get into ruts very, very quickly. We need greater contacts with the outside. He provides that.

These seven men participate in the Board Meeting every, single morning at 10:00 o'clock. No one ever misses a meeting if it's avoidable and without a good excuse, and no one is ever tardy. Our meetings are informal. We don't wear robes and we don't use Roberts' rules of order. But the meetings are orderly. Every member can speak his piece without interruption. As a matter of fact, he is expected to speak his piece on every item on the agenda. We operate on the basis of an agenda which comes to us the night before the meeting, just in time to take home and work on in the evening. That agenda will cover our whole area of functions from monetary policy to administrative matters to bank supervision. We don't delegate any single function to any member of the Board, except for housekeeping. That is delegated to one individual. We operate on the basis that, in this kind of work, we are going to come out in the long run to a better line of decisions if we have all seven men, with their very different backgrounds, focusing their attention on each given problem than if we have any one man making the decisions in that particular field. There are many times when I think I know better than anyone else what the decision should be, but I suspect that's true of my associates, too. So we think that the public interest is served best by having these various points of view brought to bear on each problem in the long run, rather than having any one individual doing it.

We operate on the basis that the majority will prevails. We press vigorously for our respective positions when we get into that Board room, sometimes before our staff and sometimes in the executive sessions. But once we walk out the door we present a united front. We think that's the only way we can function in this field.

Each item on the agenda will have been processed by the staff before it ever comes to the Board, whether it is the Legal Division or the Examination Division, bank operations, research, domestic, international, or what not. They'll process it and they'll distribute it around to each individual Board Member, and he has the job of coming to his own conclusions with respect to that item on the agenda without any caucusing. One of the things that we are rather jealous about is that no individual Board Member tries to swing the vote of any other Board Member even by discussing the case with him before we go into the Board. There we get into some rather heated arguments at times, but we come out with a feeling that, even if we are on the minority side, as I happen to be too many times, in the long run the decisions are best.

We have been very fortunate, in my opinion, in developing a staff, especially in the economic field--although I don't mean to limit it to that--that ranks second to none, anywhere. Our economists are not satisfied to obtain their raw material of facts from the usual sources in the usual ways and to analyze those in accordance with traditional patterns. There is a constant effort, which very frequently bears fruit, to obtain more representative samples quicker, from better sources, and to analyze it in ways that will provide more valid and illuminating conclusions and also will point out the defects which can be eliminated.

At the end of every business day there is placed on the desk of every member of the Board a summary of the government securities market on that day, together with a tabulation of all the major factors and any changes in it from the day before, relating to the national money market. This is only a two-page report, but it represents a great deal of high-speed, high-tension work by a group of especially trained economists and market analysts.

The very next morning we'll get a report covering the same area but in a much more lengthy form from the Federal Reserve Bank of New York, which, as you know, is the agent for the Open Market Committee. That report will not only give us the status of the government securities market and all other securities markets but also the level of member bank reserves in New York City, itself, money flows, money rates, foreign exchange, and what not.

Then, weekly, or sometimes at a little longer intervals, we receive reports covering such things as levels of member bank reserves all over the country, the condition of banks in leading cities, the condition of banks throughout the country, the trend of loans, deposits, and investments, and discussions of all monetary and banking developments both here and abroad.

Then, about every two weeks, although this comes a little more frequently, we have what we call an economic round-up. Usually we separate those. We have an economic round-up covering the national area, that is, each country, and by sections of the world. But the one I would like to deal mostly with is the other one, which relates to the domestic economy. They are both handled in exactly the same way. At one end of the room we'll have a chart shown on a large screen, while at the other end of the room we'll have 10 to 12 of our top economists giving us an oral presentation of the economic conditions prevailing in their special areas, whether it be production, consumption, distribution, prices, employment, bank creditors in general, housing credit, consumer credit, and what not. At the same time, around the Board room in which we sit, there will be about, I think, 18 charts. These are kept constantly up to date, and to me they present a more graphic and understandable picture of the economic conditions prevailing in this country than any other group of data of comparable magnitude. I would sincerely hope that, when any of you is over in the Federal Reserve Building, you will take the opportunity to go into the Board room and take a look at those charts.

Now, I mention some of the sources of our economic information merely to indicate that in this field we in the Board have a real understanding that intelligence and judgment is of very little value unless it is based on a sound foundation of fact, just as any amount of factual data is worth very little unless it is applied and analyzed with intelligence, integrity, and courage.

Let me switch to the Federal Open Market Committee. It is composed, as I said, of the seven Governors, and five of the 12 Presidents of federal reserve banks. It meets here in Washington every three weeks, and sometimes more frequently. There are occasions when we have interim meetings by telephone. Ordinarily the meetings are right here. This is sort of tough on those Presidents who have to come from, say, San Francisco or Dallas, but it's rare that any President ever misses an open market meeting. As I say, there are only five who are members, but all 12 are present every time, and they are invited not only to attend but to participate in the discussion, just as though they had a vote. This is because the Presidents serve on a rotating basis in this Open Market Committee, and this year they are members or alternate members or they will be next year.

Furthermore, in these meetings we discuss general credit control, whether it is something which the Open Market Committee has anything to do with or not--for example, discount rates or reserve requirements--so that we can coordinate the whole and see the whole picture as we proceed.

These meetings, as I say, are informal, just like our Board meetings are. The Chairman presides. The Chairman of the Open Market Committee is elected by the members of the Open Market Committee. It happens to be the same man, however, as the Chairman. He will preside. We have not only these 12 Presidents and the seven Members of the Board present, but we also have some selected members of our staff. But, to my knowledge, no one else has ever attended the Open Market meeting, ever.

We have no pledge of secrecy as such, but it is well understood that, if anyone were to disclose prematurely an action of that Open Market Committee, it would in very bad order indeed. As a matter of fact , he wouldn't stay in the system; he couldn't. So you can just take it for granted that all of the leaks one hears about from time to time in the newspapers are simply guesses couched in language to imply authenticity. No one would ever disclose what the policy action was.

How do we go about it, now? The first thing, right off the bat, the Chairman would call upon the Manager of the Open Market Committee for a report on last-minute developments, the day-to-day developments having been brought to our continuous attention. Then the economists would take over and they would give us a picture of the economy as they see it right then. This happened Tuesday of this week; that was the last meeting. They would compare it with the picture as of three weeks ago, as of six weeks ago, six months ago, or a year ago--whatever is appropriate. Then you start around the table, going to the right from the Chairman on one Tuesday and to the left the next Tuesday. It seems to me, among ourselves here, that this is a little unfortunate. I happen to sit just across the table from the Chairman, and those on my right are always, it seems to me, to the right of me, and those on the left are to the left of me. So I'm glad to start on the left once in a while.

Each of those Presidents will give a presentation, first, of the economic conditions prevailing in his own Federal Reserve District, as seen through his eyes, the eyes of his economist, and his many contacts in the business and banking world. So that the rest of us can compare that picture with the national picture to see where the trouble spots are. Then, when he finishes that, he will say what he thinks the direction of the Open Market policy should be. Should we be absorbing some of the reserves that are in the market? Should we be providing some? Is this the time when the economy should be growing, when more money should be added to the stream? Or is this the time to pull down? If so, how much? I have never seen the time, never, when there was a unanimous view as to the direction policy should take. So you can see that the Chairman of the Board has a very tough job in trying to pull out of all of these different views a consensus. Often it is necessary to take a vote, to line up the majority and the minority. Once we have determined on what the direction shall be, then we issue a directive to the Manager of the Open Market Account, and he's expected to carry that out on a day-to-day basis from the desk in New York. Either he'll be buying securities or he'll be selling securities, to offset either inflows of reserves or outflows, whether it is gold outflow or gold inflow, float, increase, decrease, or what not.

As you can imagine, we are interested in seeing how the manager carries that out on a day-to-day basis. So we have set up a telephone hookup. Every morning at 11:00 o'clock the manager in New York has a hookup with the Board here in Washington, and with one federal reserve bank, operating on a rotating basis. At that time he will give the status of the market as of that time, what he has done in the way of selling or buying securities up to that moment, and what he plans to do in the afternoon. Than that is supplemented by a report after the market has closed.

This enables the committee, at least the majority of the committee, to keep abreast constantly of what is going on, in order that, if intervening events have rendered obsolete a directive which was issued at the last meeting, we can call a new meeting.

As you can see, a great deal of information flows in a continuous stream to the Members of the Committee both before and during the meeting on which decisions are made which, in my opinion, affect the individual welfare of every person in this country.

Let me switch just briefly to the Federal Advisory Council. This is a statutory body, composed of 12 men, one selected by the Board of Directors of each federal reserve bank in the country. These men, during the time I have known anything about them, have always been bankers. Usually they are the big bankers of each district. They meet with us quarterly. They usually arrive in Washington on Sunday and start considering the questions which we have propounded to them at least two weeks in advance. This is an advisory council, so they don't tell us what to do. We ask them their views on whatever we like to know about.

One of those things is always couched in terms to draw any criticisms we can of our actions during the preceding three months. I must say that it is impossible for me to speak too highly of this Federal Advisory Council, because the members, throughout my whole term in the Federal Reserve System, have been so very forthright in giving us the benefit of their individual and collective views. They are critical, but I think they should be critical, because they are operating from hindsight, not foresight. We can benefit only from criticism. We can't do very much with compliments. I think Congress was wise in establishing this body, and I think its members are living up to the highest expectations of its creators.

We have other conferences and units within the system that one should really mention. We have a conference of Presidents of the federal reserve banks. They meet with the Board frequently--at least once every six weeks. Then we have a conference of the Chairmen of the federal reserve banks. I suppose that in the time we have here perhaps the only thing I need to say is that these conferences serve to keep the system constantly on its toes. They continuously appraise new ideas and innovations designed to speed up our operations and to enable the system to better perform its public services.

That gives a fairly brief summary of the how of the system. I have not covered everything. From what I have said you haven't the slightest notion of how a bank applies for membership in the Federal Reserve System, or how we oust a bank from membership in this system if its management isn't up to par or if its condition isn't up to par, or how we bring about improvements in given banks, or what happens to an application from a holding company to acquire a new institution, or mergers of banks, or even how we maintain our relationships with the Treasury, with the Comptroller of the Currency in the FTIC--all of which are very essential. But it is also quite obvious to me that I couldn't, even if time permitted, cover this whole area and still hold your interest. I hope, though, I have given you some idea of the how of the system, which will be amplified in your questions and answers.

Let me conclude by saying that, every time one of us is called upon to cast a vote on, for example, a problem of monetary or credit regulation, or banking regulation, there lies behind that vote a great deal of work, hours of study of selected information and views, hours of discussion with the staff, and then a considerable amount of direct exchange with one's associates around the table. At times the discussion, as I indicated earlier, gets a little heated. On occasion it even gets close to or verges on the acrimonious. I don't happen to regret that at all because I think it indicates realization on the part of the Board Members of the importance of the work they are doing, of the fact that their decisions, right or wrong, have an impact, unique in magnitude, for good or ill on the individual welfare of the people of this country.

I suspect that you have already assumed, from the fact that I have a tendency to speak in superlatives, that I can't think of any other work any place, in or out of government, which would provide as much of a challenge to whatever abilities one possessed or such a conviction that one is indeed fortunate to be able to play a part in a governmental and economic function which ranks second to none in importance, or so much real satisfaction, despite all the criticisms, when it seems as though our efforts, not just by accident but by virtue of the use of economic intelligence, are making a contribution to the economic prosperity of this country and to the aim of the system, which is an economy that is at the same time stable and growing.

That is all I have to say to you now. I'll be very glad to answer any questions that you would like to throw at me, and I hope you don't pull your punches.

COLONEL HARVEY: Gentlemen, Governor Robertson is ready for your questions.

QUESTION: Sir, I would like to get into the question of responsiveness. Does the Board generally take the big-brother approach and say, "Now, this is good for the country," or, on the other hand, do you attempt to be responsive to, if there is such a thing, what the people want? In the latter case, assuming the Congress and the Executive agencies represent the people, how do you tie in with these two departments of the Government?

MR. ROBERTSON: I think I'd have to say at the very outset that I don't know of any way in which you can know what the people want and what they don't want. Consequently, we operate on the theory that, since we don't have any feelers out by which we can really determine exactly what the will of the people is, what we have to do is to call the shots as we see them. So we do exactly that. We get all the economic information we can, we formulate our judgments on the basis of those, irrespective of what the Administration, Congress, or anyone else says is the will of the people. They can always abolish the Federal Reserve System. But that's all they can do. I don't want to hedge on any question that is raised here, so, if anyone thinks that I am hedging or that I haven't hit it squarely, please speak up again.

QUESTION: Sir, quite a few of our financial institutions are not associated with the Federal Reserve System. I wonder if you find that these institutions work at odds against or with the policies you try to achieve or the affect you try to achieve.

MR. ROBERTSON: We are in a closed session here. Consequently, I have no hesitation in saying to you that there are many institutions in this country, not only the nonmember banks, but the member tanks, that do not voluntarily gear their operations to what they know our policy is. I have come to the conclusion, over many years, that every banking institution in the United States should be a member of the Federal Reserve System. I don't think this should be a voluntary matter, because this is no longer just holding reserves for the protection of the depositors themselves. They started out with the reserves for that purpose; but they are not now. They are for the purpose of exercising general credit control as distinguished from selective credit control. Therefore, I think it is unfair that a banking institution should be able to operate on the basis of lower reserve requirements than some other one. Consequently, I think every bank should be a member of the Federal Reserve System. I think it is important. And I think then we could be more effective in the use of our general credit control instruments.

QUESTION: Sir, would you just mention briefly the liaison and coordination you have with the Treasury? Would you say it is good or bad, or do you need more, or what?

MR. ROBERTSON: You want the present and not the past?

STUDENT: Yes, sir.

MR. ROBERTSON: There have been times when the liaison was not good. As of today--and this has been true for a matter of years now--the liaison between the Treasury and the Federal Reserve has been excellent. We operate on this basis: Every Monday the Chairman of the Federal Reserve Board and the Secretary of the Treasury have lunch together and spread their problems out on the table. Every Wednesday the Under Secretary of the Treasury, Julian Baird, who was over here the other day, and

Bill Heffelfinger, who is the career Assistant Secretary in Charge of Fiscal Operations, and two members of their staff come over to the Board and have lunch with two members of the Board and members of our staff. At each of these meetings our problems are laid out on the table to them, and their problems are laid out on the table to us. We have an understanding. We never tell them what to do with respect to their problems. If they ask our advice we give it, without any punches pulled. And it works in reverse, too. They never try to tell us what to do. There was a time when Treasury did try to tell the Federal Reserve what to do, and did, as a matter of fact. That's not true today. Today each of us knows the problems of the other.

You can't separate this fiscal and monetary policy area. Monetary policy has to be geared to the needs of the economy in the light of the needs of the largest borrower, namely, the Treasury Department. You can't get away from it. That's one reason why, during the Treasury financing, we try to keep an even-keel position, so that you don't either hurt or help their financing. You don't change the rules of the game in the middle of the financing operation.

I would say that today the relationship between the Treasury and the Federal Reserve is excellent, merely because each realizes that the other one has its own job to perform, and it isn't a function of either the Federal Reserve to tell Treasury or Treasury to tell the Federal Reserve what to do.

QUESTION: Sir, I wonder if you could describe the process by which the discount rate is determined. I think this is known in the business world as "Nervous Thursday." Could you also tell us whether the vote of the various committees is a secret vote or whether it is by a show of hands?

MR. ROBERTSON: Let me take the last first, because it's simplest. There are no secret votes. In this system, and in all our operations, whether the Board or the Open Market Committee, or what not, everybody is expected to speak out as to what his views are. If they are ridiculous, he soon finds out that they are ridiculous. So that he spends quite a little time preparing himself. He doesn't want to be in that position. He wants to know what he is talking about. There are no secret votes whatsoever, and there is no just showing of hands. You express your vote and state your reason s for it.

As to the discount rates, I stated earlier that the discount-rate operation was discussed in Open Market meetings. It is. But that's not because the Board or the Open Market Committee are trying to dictate what the discount rate shall be. Those discount rates are determined by the Boards of Directors of the federal reserve banks. They meet on Thursday; that's the reason this is the day you referred to. They meet on Thursday and they will either raise the discount rate or they will lower it, or they will hold it where it is. And they'll notify us in the afternoon. We will then determine whether or not we will approve a change or whether we are going to hold it right where it is. If we do approve it, it will be announced. Otherwise it will not.

This results in having a fairly uniform discount rate throughout the country. There have been times in the past several years when one bank would have one discount rate and the rest of them would have another. From my way of thinking, that's entirely appropriate, because conditions may very well be different in one district from what they are in others. But you can't keep a difference for too long or your money flows will switch, and they'll go where the rate is lowest. So that, even the mere fact that 11 have come up to a given point will sooner or later bring the other one up, unless some of the 11 go down again.

We attempt to coordinate here, but we do not attempt to dictate.

QUESTION: Sir, turning to the question of responsiveness referred to in the first question, you gave as an answer that they can abolish the Ferëral Reserve System. But it seems like there is another solution, implied by some of the previous speakers here, specifically.

MR. ROBERTSON: I am sure so.

STUDENT: In the history of the Federal Reserve System, which I have only a speaking acquaintance with, the functions and your performance, which you described early in your talk, are vital and important, and must continue, but the policy-making aspects of this could, it seems to me, be made more responsive to the other elements of the federal economic controls that have to be exercised from day to day by the Treasury, and by the Commodity Credit Corporation, for example. Is there any reason why these can't be separated, to make the Federal Reserve policy-making points more responsive to the other aspects of the economic policy?

MR. ROBERTSON: Yes, I think it can. I think you can make it more responsive, and destroy the complete effectiveness of the system. I think you can make conditions just as easy as you want to make them. You can throw money into the stream just as fast as anyone can possibly use it. But what would be the result? I think the result would be that you'd have inflation galore, which would be our responsibility, and not the Commodity Credit Corporation's. Consequently, I think we have to call the shots as we see them from the point of view of what the overall needs are, not what the needs of any particular agency are.

That doesn't mean that we can just go about our business and pay no attention to what Treasury wants, or anyone else. We can't do that. It is perfectly obvious that we can't do that. We must be aware of and sympathetic to the needs of the Treasury, and the needs of all the other parts of the Government, and to the wishes of Congress, but that doesn't mean that we follow the position which they advocate. It merely means that we have a responsibility to understand their side of the picture in determining what ours shall be. And, if you get into a situation such as we have been in, in the recent past, and I put recent in quotes, because it goes back farther than just the past few weeks, where the factors which should be called upon to fight inflation haven't been fighting inflation, our function then becomes even more important. We have to go farther than we would ordinarily go in combatting what we think is a danger.

QUESTION: Governor, a couple weeks ago the British raised their discount rate to 5 percent, and the reason they gave for it was that the currency was fleeing the country for some foreign joint business. Yesterday I read in our papers that, because of the rapid decline in our short-term gold rate, we would probably lose a lot of gold out of our country because of higher short-term interest rates overseas. My question is: Does the Fed consider this a serious problem? If it does, what group would change what discount rate? How would you solve the problem?

MR. ROBERTSON: In the first place, I do not worry too much about the situation, and I happen to know a little about it. The British discount rate increase was based on internal conditions. I think that there is not very much reason to worry about a gold outgo arising because of it. If we did think that there was a real danger of this, in determing what your discount policy shall be, and also in determing what your open market policy shall be, you must today take into consideration events abroad and conditions abroad. No longer can we be in complete isolation here in this country. If we did think that was the situation, how would we go about increasing this discount rate here, for example, so that the money wouldn't go from here over there, following the highest rate? This is what I take to be your question. Well, as I stated earlier, we can here at the Board determine the discount rate. That's a part of the powers which were vested in the Board. The word "determine" has been construed by the Attorney General, 25 years ago, at the request of Senator Carter Glass, as meaning that the Board has the right to initiate a discount rate. So we can do that. But, ordinarily, what would happen would be that the Board of Directors of the Federal Reserve Bank of New York, which is kept abreast of conditions just as we are, would receive from us certain suggested information, without our telling the members what to do on the basis of it. On the basis of that more than likely they would raise the discount rate. That would be the procedure.

But, in response to the first part of your question, I am not concerned about this matter. It is one which deserves watching, but it is not serious.

QUESTION: Governor, I understand that when the State banks join your system they are subject to your regulations on various matters. Why, then, does any State bank volunteer to join your system? Do they make more money as part of your system?

MR. ROBERTSON: No, they don't. As a matter of fact, they make less, depending upon where they are, because some of the States have low reserve requirements, some permit all bulk cash to be counted as part of their reserves, and that sort of thing. Furthermore, some banks prefer not to have too good bank supervision. Those which do join the Federal
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Reserve System have/certain prestige which comes out of it. They do have better bank supervision, and I am not being immodest in this at all, because you have a combination of the State and the Federal Reserve. Both go into the bank. But, in addition to that, most of the State banks which are members of the Federal Reserve System can't afford not to be, because they use the facilities of the Federal Reserve System in clearing all the checks which they have. They have to have that. They can't get national accounts without

it. That's by and large the answer. There are a lot of banks that are leaving the Federal Reserve System today--maybe 25 in the last year, or, I guess, more than that, 30--chiefly because they are small and they don't need the facilities and the service functions of the Federal Reserve System--Broken Bow, for example. They can carry a lower volume of their deposits in the form of reserves; they can extend more loans; and they are not criticized for doing so. So they leave the system.

QUESTION: Sir, as I remember the history of the Federal Reserve System, it was established in 1913, and since then we have had 6 or 7 depressions and recessions, or whatever they are called. I can think of one case of a recession during the depression. My question is: Is there something wrong with the functioning of the Federal Reserve System in that it did not allay these depressions or recessions? If there is nothing wrong with the system, is there something wrong with the authority? Or do you not have enough authority to take certain control of the economy in order to level out these recessions and depressions?

MR. ROBERTSON: My answer to you, sir, is that there is something wrong with the system, and that is a lack of perfection. We are just human beings. We are bound to make mistakes. If we could operate on the basis of hindsight we'd do a pretty good job. But that isn't the whole answer. A lot of the depressions that we have had came before the Federal Reserve had the powers which it now has. In the Banking Act of 1933 and 1935 the powers were broadly expanded, so that the Federal Reserve can now discount any kind of paper, for example. There's no reason for any bank today to close because of illiquidity. We are in a position to provide all the funds that are necessary. But that wasn't true in the 1920's and up through 1933. Secondly, it seems to me that the remarkable aspect of economic developments in the past decade--that's an easy one to take a look at--isn't that we've had some inflation--we've had some inflation and that's very bad. And we have also had some unemployment at times, and that's a matter of real concern to us. But the remarkable thing is that, during this period, we have had a very high degree of growth and prosperity without any wild speculative boom on the one side or any disastrous or prolonged depression on the other side.

Now, there are those who contend that the Federal Reserve, if we have the powers that we say we have, ought to be smart enough so that it levels off the upswings and levels off the downswings, so that you get pretty much in the middle. That's where we try to get. We try to, as I said earlier, moderate these upswings and moderate the downswings.

The trouble comes because there isn't any man smart enough--I don't care who he is or where you look for him--to see on the upswing just where it is going to top off, because, you see, most of it comes as the result of tightening the pressures. You tighten them, but you never know what is going to be the real effect. You tighten them and pretty soon it does turn down, and then, if you started too late and it got too tight, it turns down too abruptly. Then you start to put more reserves in to get the money supply going again, but it doesn't develop, because so much depends not only on the volume of money and credit that you have but on the velocity, the turnover, of that money. You take a $5 bill and turn it over five times and you have $25. You turn it over 100 times, and you have $500.

So that it depends upon what people do and what spending, for example, Congress has authorized, what is going on in the labor field in the way of increases beyond the productivity, and on many things, other than just money and credit. So that we never can be successful in just cutting off these upswings or these downswings.

I would really think, in response to your question, that we have been fortunate in the past decade and in the whole postwar period in not having anything in the nature of a disastrous downturn or a prolonged downturn. I would also say that, from here on out, you are never going to see a time, I think, when you completely abolish business cycles so long as you have a free-enterprise system working. I think the benefits of a free-enterprise system are worth it.

QUESTION: Certain economists, in testimony before congressional committees, have indicated that the difficulty that we have had with our constant growth rate stems in part from the fluctuations up and down which to some extent are the result of the federal action there to prime the pump or to dampen the effect. They hold the view further that, to insure a stable rate of increased growth, we should have a stable rate of increased input of money, in other words, a stable increase of money rather than the fluctuations which seem to discourage progress.

MR. ROBERTSON: I have read those; I think every one of them. I have debated many times with those who hold that view. I think I can sum up my own views by saying that, as I see it, there are too many people in this country playing a sort of numbers game with respect to growth. I don't think it is possible for any individual to really know that a 3.5 percent per annum growth rate is too low for our economy or that a 5 percent is too high. I don't think anyone can know that.

Well, that being so, I don't see why, perhaps, someone shouldn't ask: "Why can't we just let people do this and consider it as sort of a harmless pasttime?" The trouble is, as I see it, that this sort of game has a sort of traumatic effect on the participants, and I think in the end it may involve all the spectators in a sort of very disastrous experience. Magic numbers are sort of thrown up from time to time to indicate that we are losing in this growth-rate race with Russia and losing by some computations by a score of something like 3 percent for us to 7 or 8 percent for Russia. And some of the economists think this is a very great defeat and that it calls for heroic remedies.

Well, I submit that we are not falling behind by any such drastic figures. If you'll take a look at the growth in this country from the time when each one of you was young, as compared to what we have in this country today, you'll see we have made some pretty good strides. If you want to take a look at my home town, for example, Broken Bow, and any of you who were born in a similar town will have exactly the same reactions--when I was a boy, we had no paved roads, we had no automobiles, we had no electric lights; we didn't even have electric can-openers. The difference between then and now is terrific. I don't think we want to just follow in Russia's footsteps. I think we want to grow as rapidly as we can, but it must be on a sustainable basis.

Therefore, when people contend that we ought to be using some sort of a mechanistic formula to put more money into the stream on a regular basis—whether they use a 2, 3, or 4 percent basis, I don't care--what they are doing is saying that that amount of money is going to have the same effect under any circumstances. I say, if you say that you just don't know what the situation is. You are misjudging the problem completely, because, with a given amount of money reserves in the banking system--that's what they are talking about--the money supply goes out. That money supply is infinitesimal in relation to the use of that money supply. It is the turnover of that money supply which is important. Therefore, you have to gear the overall supply of money and credit and the overall supply of goods and services.

I think we are growing fairly well at the present time. I think there are areas in which we could improve things. I don't mean to go off on a speech here because of one question which is raised, but I think it is important, because this whole growth thing has been turned, I think, out of line.

Let's see where the critics really line up. They say growth is bad because it results in unemployment, the lack of growth. Well, that's right. We do have unemployment in this country, too much unemployment in this country. Even the critics don't say that we should be able to get along without any unemployment, because some people are always changing jobs. Their goal seems to be about a 3 percent rate. I say to you that the difference between that 3 percent rate and the present 5 percent rate is represented by pockets of unemployment in particular areas--in the coal-mining and railroad communities up in Pennsylvania, in the textile towns in New England, despite the present boom in textiles, and in some other hard goods areas. And I think maybe there is something we ought to be doing to help those people develop new skills and find new jobs. But they are not going to be helped by merely increasing the money supply.

Let's take another area. There are those who contend that we are not devoting enough of our resources to the production of the right kinds of products. For example, we are not spending enough money on education or on defense or on public services. My answer to that is we can have anything we want in the way of public services if we are willing to pay for them. In New York State, for example, just last year, they decided that certain public services should not be contracted but should be expanded. So the legislature enacted new taxes to pay for them. Any other community can do exactly the same thing. We can have whatever public services we are willing to pay for. But what we are unwilling to pay for monetary policy can't provide us.

QUESTION: Sir, I want to ask you about the recent criticisms that have been leveled at the effectiveness of the general monetary controls that you are now authorized to apply. I believe that a joint congressional committee recommended that there should be selective controls, say, in the field of consumer credit, and that even the American Banking Association felt that this was a matter that should have serious study. Do you have any views on it, sir?

MR. ROBERTSON: Yes, I have very definite views, as you can guess. I am not one of those who contend that general controls are completely effective. They are not. Sometimes it takes a long time to get the results you are looking for. You have to increase the pressure a little bit, take it off, then start it up again. It's sort of like driving a car down the road. You turn a little too far and you have to turn back. There are areas in which selective controls can be more effective under given circumstances. But I find myself in the position of thinking that, if you put selective controls into effect on, as the committee suggested, consumer credit, I see no reason why you shouldn't also put selective controls on housing credit, on every single kind of credit. And then I reach the position --well, if you are going to put it on credit, why not put it on production, on the other side? Pretty soon I get myself into the position of thinking, well, if you are going to operate by virtue of selective controls, you have to go the whole way, and then you don't have a free-enterprise system; you have what Russia has. That's not what I want. So what I say is, with all its awkwardness, I prefer the general control method, leaving people the greatest amount of freedom they can have, because I think it is that freedom of the exercise of individual initiative which is responsible for the kind of country we have today. Therefore, I don't go along with those who think that, as of today, we ought to have selective controls in any given area. I prefer to stick to the general credit controls, realizing they are not perfect. They are a lot more perfect than would be the selective controls, because, in order to really utilize selective controls, you must have supermen using them. I don't know of any such, not anyplace.

COLONEL HARVEY: Governor Robertson, on behalf of the Commandant and the College, I express our appreciation for your very fine exposition of the policy workings of the Federal Reserve System in exercising its monetary responsibility. Early in your talk you mentioned that serving in the system was not conducive to popularity. I am sure there are at least two areas where that isn't true. The first is Broken Bow, Nebraska, and the second, which must be obvious to you, is in this room.

MR. ROBERTSON: Thank you.