REMARKS OF ALLAN SPROUL, PRESIDENT,
FEDERAL RESERVE BANK OF NEW YORK,
AT THE MID-WINTER MEETING
NEW YORK STATE BANKERS ASSOCIATION,
JANUARY 25, 1954

Independence of the Federal Reserve System

I hope that you will not hold me too closely to the assigned topic of my talk this evening. I intend to weave in and out around it, but I am not going to try to give you an historical and philosophical dissertation on the independence of central banks. Even if such a task were not beyond my powers of exposition, it would probably be beyond your powers of endurance.

The subject is continuously interesting to central bankers, however, and it may be that by relating it to banking discussions and credit policy in recent years and months, I can make it of some interest to you. It is important, I think, that neither frozen attitudes of mind concerning the past independence of central banks, nor misconceptions of the present situation of the Federal Reserve System, be allowed to jeopardize a position which, even though it be confirmed from time to time, is never free from attack. The possibility that there might be a "money power" able and willing to flout the economic policies of elected Government, or exposed to the coercion of special private interests, disturbs many men and attracts demagogic assault.

When your President asked me to speak tonight, I told him that I thought the bankers of New York State, and of the Second Federal Reserve District, have a special call upon my time and energies. This could be seized upon by those who hold that the Federal Reserve System is banker-dominated, and banker-oriented in its attitudes and actions, but it carries no such implication. Our relations with you are close to be sure, but this is necessary both as a matter of law and as an aid to the proper functioning of our money economy. In the performance of our primary duty of relating the supply of money to the needs of agriculture, commerce, and industry, and of our secondary duties such as supplying coin and currency, collecting checks, and supervising member banks, we necessarily work with and through the private banking system.

Our objective in both areas, however, is to meet a public need. In the first instance it is to provide, to the fullest extent permitted by actions of Government and the private economy, over which we do not have control, a money supply which has reasonably stable purchasing power and which will contribute to the steady growth of the economy. In the second instance, it is to promote the improvement of our banking facilities for the benefit of every citizen, whether or not he ever borrows from a bank or makes or withdraws a deposit.

One line of criticism of the Federal Reserve System, which during the past year has made ominous forays into the public prints, is that the Federal Reserve Banks perform all sorts of free services for the commercial banks of the country, while charging the Federal Government for many services performed for it. We are accused of favoring private institutions as against the Government and of using funds, which otherwise would revert to the Government, to consummate this favoritism. As a consequence it is sometimes suggested that the Federal Reserve System be brought within the budget-making orbit of the Congress, and be subjected to the general accounting procedures of the Government, presumably so that these twin "evils" may be curbed or eliminated.

It is a narrow and myopic view, I think, to look upon the services we perform for our member banks as subsidies to the banking business. If there are such subsidies, as distinguished from services that we can and should perform at no cost or low cost, as part of our job of providing efficient monetary arrangements for the nation, they should be eliminated. But the real and overriding purpose of these services, when wisely conceived and economically performed, is the provision of that better banking system, which the original Federal Reserve Act envisaged, and which is a necessary part of the proper functioning of our economy. Banking in this country is a highly regulated public utility. Individual banks are operated for the profit of their stockholders, but the banking system as a whole operates for the benefit of the community. And it is the Federal Reserve System which, nationally and in collaboration with the Comptroller of the Currency and the Federal Deposit Insurance Corporation, draws all of these private units together, and with them and through them tries to see to it that the public is provided with efficient and effective banking facilities, in the form and at the place where these facilities will be most useful. The expenses which we absorb in pursuit of this objective are not subsidies to the private banking system. They represent a service to everyone in the country who depends on the proper functioning of our monetary system. And that means everyone.

Reasonable men and friendly critics are somewhat attracted, nevertheless, by the idea that these expenditures of the Federal Reserve Banks should be brought under the budgetary control of the Congress, and the subsequent review of the General Accounting Office. If there were real abuses to be corrected, this might be one solution, albeit one which would introduce the unfortunate but probably inescapable element of rigidity of "Big Government" and bureaucracy into operations which, both on behalf of the Government, as its fiscal agent, and on behalf of the public, through the member banks, require a high degree of flexibility in the allocation and uses of funds. For myself, I do not believe there exists any possibility of abuse which cannot be detected and eliminated under present procedures, or improvements in those procedures. The facts as to the earnings and expenses of the Federal Reserve Banks are readily available. The efficiency of operations of the Federal Reserve Banks is open to the daily observation of all who have dealings with them. Their operations are under the immediate scrutiny of boards of directors performing a public service but, in most cases, used to the compulsions of operating a private business for profit. And the banks are subject to the check and audit of the Board of Governors of the Federal Reserve System at Washington. There is no lack of control of the financial affairs of the Federal Reserve Banks.

On the question of the services which, as fiscal agents, the Federal Reserve Banks perform for the Government, and for some of which a charge is made, I am inclined to believe that both the public and the Congress would look with a jaundiced eye on a broad extension of the free list. The net cost to the Government, in any case, is a small one, since the charges made for fiscal agency operations prevent erosion of the net earnings of the Federal Reserve Banks, approximately 90% of which are now paid to the Treasury. And there are dangers as well as costs to be considered. The first danger here is that extravagant Government departments and bureaus, or economy-minded agencies, depending on which way the wind is blowing, would find this a convenient way to improve their own budgetary position, and to escape some of the controls of the Congressional appropriation procedure. There must be literally hundreds of financial housekeeping jobs, I suppose, which Government departments might seek to have performed free of charge by the Federal Reserve Banks, as fiscal agents of the Government, if the doors were opened to this sort of thing. The final danger would then be that the Federal Reserve Banks would become swamped with these incidental, mechanical functions to the detriment of the performance of their primary duties as central banks.

It is no help in the resolution of questions such as these, of course, to find that there are many bankers who still think that the Federal Reserve Banks are "making money" out of member bank reserves and who do not realize that, on the contrary, the Reserve Banks have for a long time been creating reserves to provide the basis for present day deposit banking. These bankers are inclined to argue that the Federal Reserve Banks are making large profits out of the use of the reserves deposited with them by their member banks, and that these earnings should be used to provide more "free services" for the member banks, instead of being paid over, in large part, to the Federal Government. Such argument not only gives support to those who see in this matter only a question of division of spoils between private banking institutions and the Government, it also indicates a tenacious misunderstanding of how our reserve deposit banking system really works. The reserves originally paid into the Reserve Banks by their member banks were not, of course, earning assets and did not become such by this shift from one vault to another. And over the years these reserves have long since been submerged under a thick layer of reserves created by the Federal Reserve Banks, using the powers granted to them by the Congress. The reserves which you paid into the Reserve Banks could be put back into your own vaults, and they would be there just as inert as they now lie in the vaults or, better, on the books of the Reserve Banks. The reserves which we created, primarily by buying Government securities during the war, now find a reflection in the substantial earnings which we report each year. And similarly created reserves will be a similar source of earnings for the Federal Reserve Banks, if the reserve base needs of a growing banking system in a growing economy continue to be met in this way. We do not live on the reserves which you once placed with us.

This has nothing to do, of course, with the level of reserves which different classes of banks are required to keep with the Federal Reserve Banks. If the percentage amount of your required reserves is increased there will be, in effect, a transfer of earning assets from the member banks to the Reserve Banks. And if the percentage amount of your required reserves is reduced, there would be a reverse movement of such earning assets. Perhaps this has helped to confuse the picture. The way to get at this situation, however, is not to demand free services from the Federal Reserve Banks, but to examine the history and effect of present reserve requirements, to see if some more up-to-date and more equitable method of fixing reserve requirements cannot be devised. The Federal Reserve System has made studies of this problem, and it is one which will have to be solved at some time if our fractional reserve banking system is to keep in step with changing conditions. But so far the interest which the banking community has shown in the problem has been small, sporadic, and perhaps, too much tinged with the particular interests of particular groups of banks.

Well, you now have a right to ask, what has all this got to do with the independence of the Federal Reserve System? Only this. If the charge can be made to stick that the Federal Reserve Banks now serve primarily the selfish and pecuniary interests of the private banks, the independence of the Federal Reserve System will be in danger. Whether the attack be a frontal one, involving so-called nationalization of the Federal Reserve Banks, or whether it be an encircling movement putting the Federal Reserve System in with sprawling Government departments, subject to stereotyped Governmental budget and accounting procedures, the independence and the regional character of the Federal Reserve System--and, I believe, its effectiveness--will be undermined. It can happen here, particularly if bankers themselves do not take the trouble to broaden public understanding of the basic principles and the organizational advantages of the central banking system which have evolved in this country.

In defending what we have, however, and in trying to improve it as we go along, we may be in danger at the hands of friends as well as critics. Here I have in mind some of the fiction which, it seems to me, is getting mixed up with the facts about our experiences during the war and post-war period, and some of the loose language which is being used to describe our recent adaptations of flexible credit policy.

I shall refer to the earlier period only briefly. It is becoming part of the legend that during the war, and during the post-war years until March 1951, the Federal Reserve System was the supine servant of the Treasury. The demands of capsule treatment of a difficult period in credit policy and debt management seem to make for such easy generalization. So far as the war period is concerned, I think it is closer to the facts to say that the Treasury and the Federal Reserve System reached an agreement, with some compromises along the way, as to war financing and credit policy. It is quite true that we lost our "independence", but we lost it to the inexorable demands of war. It was not meekly handed over to the Treasury in abdication of our responsibilities.

The long post-war delay in dismantling war financing policies is less defensible. Our problem was to recapture from the commercial banks of the country, and other holders of Government securities, the initiative with respect to the creation of reserve credit, and to restore the ability of the Federal Reserve Banks to vary the availability and the price of such credit to meet changing economic conditions. The problem was complicated by the fact that the Treasury faced, during these years, an unprecedented job of funding and refunding an enormous mass of public debt, and by the fact that large segments of that debt had not yet settled into firm hands. The bases for strong differences of opinion existed even though we and the Treasury professed the same ultimate objectives. The result of our debates was a policy so cautious, so hesitant, so distrustful of general credit measures, that credit policy lost much of its effectiveness. It is worth remembering, though, that during much of the early post-war period the Treasury was drawing in cash surpluses which were used, to a significant extent, to reduce bank reserves, and thus to offset much of whatever harm was done by our release of reserves in support of Government security prices.

Here again, however, there was no meek surrender of independence; this time it was a running fight all the way. And we did accomplish something as early as 1947 with the unfreezing of short-term interest rates, which enabled us to offset with one hand, by sales of short-term Government securities, what we were doing with the other, in support of the long-term market. But despite such qualifications, those who hold that we should have acted sooner than we did to restore our freedom of action probably express the majority opinion. But to impute our failure to a lack of courage, in defense of our independence, is like sitting in the bleachers and demanding more courage of some young men who are having all they can do to stay in the game.

There is one prime fact to be remembered, also. A more independent, more effective monetary policy could not have prevented the post-war inflation; at best it could only have slowed it down. The big damage had already been done. The money supply of the country had been increased from $36 billion to $102 billion during the war, without any similar increase in civilian goods and services. The inflationary effects of this warborn development were suppressed but not eliminated by direct controls. They were bound to break out, unless we were ready and able to embark on a drastic program of deflation which would have resulted in a decline in production, a decline in employment, a decline in income, and a decline in consumption. I did not then and I do not now believe that this would have been the right prescription for the troubled post-war world, when so much depended on this country's economic strength. A credit policy so drastic as to erase the inflationary effects of war financing was not the answer. We had to grow up to the wartime expansion of the money supply through an increase in production and prices, moderated by increases in productivity. Perhaps we could have prevented some of the increase of $10 or $11 billion in the money supply which took place in 1946 and 1947, but the money and credit requirements of a massive readjustment from a war economy to a primarily civilian economy would have made even this doubtful.

When our economy had pretty well grown up to the new monetary magnitudes decreed by war and when, after the mild recession of 1949, the outbreak of hostilities in Korea set off a new spiral of inflation, we did act promptly and vigorously. This involved us, in August 1950, in a public knockdown and dragout fight with the Treasury, which we had been trying to avoid for so long, in what we conceived to be the national interest. The independence we then asserted was broadened and affirmed in the "accord" of March 1951, with growing support of banking and public opinion.

That support has been evident ever since, and has found expression in the findings of two Congressional committees charged with looking into our actions and status. What we have to guard against now is renewed erosion of our independence.

To illustrate this danger, I might quote from a weekly magazine of enormous circulation. In a recent issue it published a picture of the Council of Economic Advisers with the caption "President's Prophets" and then indulged in some prophecy of its own about the anti-depression planning of the present Administration. One section of this statement said that "the 'tight money' policy, which has already been liberalized, would quickly be switched to fast expansion of credit by decreasing Federal Reserve margins, resuming the price-pegging of government bonds, and stimulating instalment buying." The implication was that this remarkable hodge-podge is part of the Administration's anti-depression planning, and that the Federal Reserve System is in the Administration's pocket so far as the implementation of such a program is concerned.

Or take another example from a banking magazine published in London. "The attempt of the Republicans to go back to Coolidge and 'sound money' has failed before it started. At the first whiff of deflation Mr. Randolph Burgess and Mr. Humphrey, the big battalions of the dear money and 'putting value into the dollar' school, broke and fled, leaving the rearguard action to the hastily organized open market operations of the Federal Reserve." Here we are tied in with the monetary ideas of President Coolidge, and charged with being used as expendables by the present Administration, when all the time we thought we were acting on our own non-political initiative to accommodate credit policy to the needs of a changing economic situation.

An erudite domestic critic puts it more subtly. He says we have again become subordinated to the Treasury by a process of intellectual osmosis. It all seems to add up to the charge that the independence we achieved in 1951 was given up again in 1953.

Now what exactly have we done during the past year? I shall leave out the way we have done it, which has caused some intra-mural debate, and confine my discussion to broad policies and broad objectives. The story cannot be definitive, of course, because to a certain extent we have been pioneering, and we shall need later judgments properly to assess the results. If we had only to work by the book, we should not have had to cope with, first, inflationary excesses and then with deflationary dangers, while the Treasury was almost continuously a borrower or prospective borrower of new money to meet cash deficits.

My outline, then, will be just a broad sketch of policies as they appeared at the time. In January 1953, there was considerable general or non-statistical evidence of some revival of boom psychology in business, supported to some extent by the statistics of November and December 1952. On the other hand, in the critical area of prices there was little confirmation and some denial of the emergence of inflationary forces. We were concerned, however, about consumer spending increasing faster than consumer income, the increasing investment in inventories, and the possible consequences of the prospective removal of remaining price and wage controls. The situation was characterized as precarious balance at high levels. In such circumstances a continued policy of mild restraint of credit expansion seemed indicated. In keeping with such a policy and consistent with previous open market operations, the discount rate was increased in January from 1 3/4% to 2%, and gains in banking reserves, resulting largely from the return flow of currency from hand to hand use, were offset or slightly more than offset by reductions in our holdings of Government securities. As an indication of the mildness of this holding action, the member banks gained about $1,200 million in reserve funds from January 1, 1953 to mid-March, through the return flow of currency and a decline in required reserves, and lost a little over $1,300 million through gold and foreign account transactions and a reduction in the Government security holdings of the Federal Reserve Banks.

As we came into the spring season, however, the need for alertness to signs of possible declines in economic activity increased, highlighted by the decline in farm prices and farm income and the then unpredictable economic consequences of the cessation of fighting in Korea. At the same time, the pressure of an unusually sustained private demand for bank credit was augmented by the emergence of Treasury needs for new money, some of which would have to come from the banks. These cumulating pressures, operating against a policy of mild restraint on the part of the Federal Reserve System, converted that policy into one of more severe restraint than the economic situation seemed to justify. The risk of giving a final fillip to unwholesome inflationary developments, of creating a bubble on top of a boom, had receded.

Taking cognizance of this situation the Federal Reserve Banks began buying Government securities in the open market during the week ending May 13 and, before the month was out, a total of $157 million of Treasury bills had been purchased. In addition the amount of reserve credit in the market was increased by $125 million through repurchase agreements made with non-bank dealers in Government securities. A net increase of $282 million in reserve funds available to the market is no small chunk. It might have been considered as a significant sign of a change in policy and of a prospective easing of credit availability. But markets are creatures of expectations as well as events, and the money market and capital market had become disturbed and jittery, in the face of what they thought would be normal increases in private demands for funds during the second half of the year, accompanied by Treasury demands which seemed to grow in size with each new estimate. There was no immediate reaction to our relaxation of credit restraint during May. We were up against the fact that, at best, central banking is an art, not an exact science, that there are lags of unpredictable duration between action and reaction, and that our problems are still quite largely problems of human behavior.

The market had to be shaken out of the view that credit would not be readily available during the second half of the year, if we were not to run the risk of giving deflationary influences a hard shove into the foreground, by reason of faulty market assumptions concerning future credit policy. The action the System then took was precipitated in timing and form--but not in substance--by the needs of the Treasury. Our open market operations were stepped up in June, and lower bank reserves were announced to take effect early in July. The cynic or the skeptic can say that this reduction in reserve requirements coincided too neatly, in timing and amount, with the reserve needs of the banks, as related to Treasury borrowing, to pass muster as an act of credit policy. The alternative, however, in the face of the necessitous borrowing of the Treasury, was to allow that borrowing to press hard on bank reserves and on private financing, at a time when the economy was no longer balanced between inflation and stability, but between stability and deflation. It seemed to me then, and it seems to me now, that it would have been economically unjustified to run the risk of tipping the balance toward deflation.

From early July until early September, we followed pretty much a hands-off policy while the economy moved sidewise at high levels and with stability in the broader price indices. We had become convinced, however, that it was safe to make our errors on the side of credit ease and, during September, we began to anticipate the expected increase in demand for credit during the last quarter of the year. The fact that private demands for credit did not come up to seasonal expectations made it look as if we had overshot the mark by our purchase of $359 million of Government securities during September and the first week of October, and this exposed us again to the charge that we had become creatures of the Treasury's needs. I have no hesitancy in saying, however, that our policies were dictated primarily by economic factors, other than the Treasury's debt management problems, and that whatever mistakes we made were not dictated mistakes.

It is an unfortunate fact that our estimates of what may happen to bank reserves from day to day and even from week to week, as a result of ordinary market factors, are not too accurate. Over a longer period they come out pretty well, but the intervening swings may be wide. If we were going to give the business community and the money market a lead as to credit policy during the last quarter of the year, when it seemed necessary that there be no question of the continued availability of reserve funds, we had to run the risk of overshooting our immediate objective in order to achieve the longer term result.

When the demand for reserve funds again began to catch up with the supply at the end of October we resumed open market purchases of Government securities and carried on through the year-end. And, as the special demands of the year-end began to impinge on the central money markets, while the reserve position of the rest of the country remained easy, we gave special relief to the money market by reducing from 2 to 1 3/4 per cent the rate applying to repurchase agreements with non-bank dealers in Government securities. In this way the dealers were enabled to supply a temporary home for short-term Treasury securities which corporations and others wished to convert into cash in connection with year-end adjustments, and the banks were provided with additional reserves with which to meet seasonal demands.

There, in brief, is the story. We have been trying to do what it is possible for monetary management to do in helping to maintain a high level of production and employment without encouraging inflation or deflation. In the process we have moved from a policy of mild restraint, when the business situation still had some aspects of a "boom", through a brief period when market expectations induced more vigorous restraint than we had contemplated, to a policy of increasing ease, as signs of a modest and gradual downturn in the economy became more and more evident. At no time since last June has there been any real concern about the ready availability of reserve funds needed to support the credit requirements of the economy.

On the record, therefore, and without claiming too much credit for what has happened, because monetary policy, at best, is only one part of the picture, I would say we have been reasonably successful. Up to the end of 1953 adjustments which were taking place in the economy proceeded gradually, without setting off a chain reaction of downward movements. If this continues, present policies plus the normal forces of growth in our economy, which are very strong, should be sufficient to reverse the movement before it has gone too far, too fast. If a cumulative decline should appear to be getting under way--if this second transition from "war" to "peace" should show signs of economic breakdown--it would be necessary to try to check the movement with more positive measures.

I now submit that the record of the Federal Reserve System during the past year has been the record of an independent central banking system, performing its functions within the framework of the American political system, and in the light of the economic conditions with which it was confronted. It is less than accurate, and less than fair, to try to shove it back into a niche at the Treasury. To be sure our policies have been consistent with the over-all economic policies of the Government, and have coordinated well with the debt management policies of the Treasury. That is what you would expect when reasonable men have the same objectives and are working from the same set of facts in formulating their policies and programs. We do not seek to use our independence to oppose Government, merely for the sake of showing our independence. That would be intolerable and impossible. As I have said before, our independence is within the Government of the day; we cannot be independent of the Government. But neither can we afford to be--even be suspected of being--independent within the Government when it is of one complexion, and subservient when it is of another. If that should happen, our independence would be a sham, and would be destroyed with the next turn of the political wheel of fortune.

That is why I have taken your time and tried your patience with this review of our policies during the past year. It is important that they be understood, if we are not to begin to slip again into a situation which, eventually, would bring the independence of the Federal Reserve System into jeopardy.

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A Suggestion for . . . . .

A Nation-Wide Study of Banking

BY ALLAN SPROUL, President, Federal Reserve Bank of New York

Before the Twenty-Eighth Annual Mid-Winter Meeting of the New York State Bankers Association, January 23, 1956

IN THE PAST I have used this occasion, at times, to make a few remarks on some current banking problem. At other times I have been more cautious, and have merely expressed the pleasure of the Federal Reserve Bank of New York in having the members of the New York State Bankers Association as its guests. Today I am going to go somewhat beyond the formal and the safe, although still expressing our pleasure in being your host.

I am not joking about the safe part of it. What I am going to do is to inject myself a little way into the fight which has been going on for some time between and among the commercial banks and the thrift institutions, and to essay the role of friend of all parties. This is a dangerous role and, more often than not, results in the combatants turning on the amateur peacemaker. And since the peacemaker, as in my case, usually doesn't know all there is to know about what caused the fight, he is fairly open to attack. Nevertheless, since I speak with nothing in my mind and heart but the best interests of our financial institutions, and the public which they serve, I am ready to run the risk.

The fight I am referring to is the battle which has been going on intermittently, but for some time, between the commercial banks, the savings banks, and the savings and loan associations, with respect to their overlapping fields of operation. It has seemed to me that, perhaps, in the heat of combat over relative advantages, the common interests of all parties, and of the public, have tended to be submerged. And yet these are the interests which should and, in the long run, will determine the outcome.

I hope, therefore, that in the studies which are now being made by the State, by your Association, and by others, this broad objective will be kept to the fore, and that some of the narrower differences among you, which have generated so much heat in the past, will occupy a place of less importance. What should be the goal of all parties to these disputes is a fair field in which to exercise their appropriate and partly competitive functions.

The question then becomes what is a fair field for healthy competition in the provision of complementary and sometimes overlapping services? To that question there is no easy answer, given the fact that we start out, not from scratch, but from the midst of a thicket of inherited laws, rules, and practices. In this thicket, some aspects of healthy competition may have become qualified and diluted so that one segment of the public ends up paying for advantages enjoyed by another segment, with no net gain and, perhaps, some net loss to the community as a whole. If there is to be an answer to a hard question, therefore, which will satisfy the reasonable requirements of reasonable men, I think it must come from a complete re-examination of our banking and thrift organizations at the local level.

Open Range vs. Fenced Pastures?

For the best interests of the community and of the nation, what is the proper role of commercial banks, of mutual savings banks, and of savings and loan associations? The degree of feeling on this question varies in different communities and regions, but as competition intensifies, it becomes very acute. We print Mr. Sproul's speech because, first, it isolates the problem with cool detachment and, second, because it suggests an objective approach that should appeal to fair-minded people.

We shall have to start from the premise that these various institutions, by and large, operate in the field of regulated business, and in a field in which there is so high a degree of public interest as to require commensurate public regulation. But the regulation has been and is at two levels, national and state, imposed by different hands in different ways, and its incidence has not always been equitable. Of the differences which have aroused you, many have grown out of this situation, and they are not the kind of differences which can be resolved solely by competitive forces, or by individual state action.

The commercial banks occupy a unique position in this complex, because they are the only institutions which, in a sense, "create" credit — not out of nothing to be sure, but because of their ability to create deposits in exchange for other less liquid assets or the carefully assessed ability of borrowers to create such assets over time, all on the basis of a fractional reserve system. If commercial banks confined themselves to commercial loans, short term liquid investments, and demand deposits, of course, they would be much less involved in current controversies than they are. It is the present day department store commercial bank, with its mixture of demand and time deposits on the liability side, and of various kinds of loans and investments of various maturities on the asset side, that brings the commercial banks into the conflict. Because they believe, and with some reason, that this is the only kind of institution which can provide a community with all the different kinds of banking and thrift services which it needs, the commercial bankers have tended to assert what would seem to be a pre-emptive right to operate in certain areas. They have argued that the intrusion of thrift institutions, or their branches, into these areas might make existing commercial banking ventures unprofitable, and eventually result in a deterioration of the rounded services the communities need.

And this kind of argument, in turn, leads into the controversial question of present laws and rules with respect to unit and branch banking, because the ability to survive under such conditions, and to continue to provide complete banking services to the community, may depend in many instances on the institutional form of the commercial bank. Without trying to develop that ticklish theme further, I think it can be said that the commercial banks and the thrift institutions have split largely on the question of whether commercial banks can continue to exist, in some areas, if deprived by local competition of part of their savings deposits, and whether this would not mean that the communities concerned would be deprived of complete and adequate banking service.

The mutual savings banks have also come a long way since they were small struggling institutions gathering together the deposits of small savers in a more or less single-handed battle to promote thrift as well as to marshal community funds for investment. The size and variety of their operations have been expanded around this core of purpose and being, so that they now seem to be trying to do many of the same things that the commercial bankers do. And yet, it is claimed, they still retain privileges and exemptions which were appropriate in their earlier status, but which tend to weight the competitive balance in their favor now. And so there is greater opposition than there otherwise would be, I assume, to the expansion of the field of their operations, even where movements of population are tending to deprive them of potential depositors.

Finally, for the purposes of this brief comment, there are the savings and loan associations, those special purpose institutions which have been aggressively successful in creating a widespread public belief that they accept savings deposits and operate pretty much as do mutual savings banks or the savings departments of commercial banks. In their present form and importance, they are largely the creatures of a revolution in methods of financing home purchases and home building which has taken place during the past 20 or 25 years.

Short Term Money; Long Term Uses

I think that this was a necessary revolution but, in the process, the savings and loan associations may have been given certain privileges, and certain advantages over their competitors, which are not consistent with the ideal of a fair field and healthy competition. For example, if their privileges are based on their special character as thrift institutions, promoting the application of savings to the spread of home building and home ownership, should they also have such ready and almost assured access to short term banking funds as they now have? The process, in effect, involves loans or commitments by the associations beyond the inflow of savings, discounts of mortgage paper with the Home Loan Banks, and the sale of short term paper, with the flavor of Government backing, by the Home Loan Banks to the commercial banks. In this way, short term banking funds in excessive amounts may be put to long term uses, with avoidance of the discipline of thrift.

And then, of course, there are the disparate branch privileges of the Federal and State chartered savings and loan associations, which have created so much controversy, and which again raise questions as to our whole tangle of laws and regulations regarding the branches of banking and thrift institutions.

Well, I have said enough, I think, to indicate what I had in mind when I suggested that there are fundamental problems below the surface of those issues which have tended to split apart the financial community, and which will have to be dealt with if we are to be reasonably satisfied with our remedies. What I wish to stress is that these problems will require attention at the national as well as at the state level. I would hope, therefore, that the work which is being done on these problems by this Association, by other associations, and by the State, will not only be first class but that it will stimulate and provoke national consideration of the same general problems. I would not be so theoretical as to ask you to forego trying to win a few local skirmishes, but I do suggest that the real victory, which will benefit all parties concerned, including the public you serve, will come from a fresh and thorough examination of our whole national banking and thrift machinery. A national study of the present character of our banking and thrift institutions, and of the laws and rules under which they operate, is needed. It is essential, I think, if we are seeking a fair field where each of the players can offer his special facilities, but where none of the players will have special privileges, not balanced by special responsibilities. It should not be too much to expect that all factions can unite in promoting such a national study, and I recommend it to you.

December 7, 1954
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Comment on Answers of Chairman of Board of Governors to Questionnaire of Flanders Subcommittee

Your subcommittee had addressed five questions to the Chairman of the Board of Governors of the Federal Reserve System, and his answers have been made available to other participants in these hearings, as well as to the public. With respect to the answers to questions one, two, four and five I am in general agreement, even though there might be some shades of difference of opinion or degrees of emphasis in answers to the same questions which I might prepare.

This suggests the first point which I would like to make. So far as general credit policy is concerned there has been a high degree of unanimity within the Federal Reserve System throughout the period covered by your inquiry - that is, since March 1951. Our differences, or my differences with other members of the Federal Open Market Committee, have related to the techniques of open market operations, not to general credit policies.

It is to these questions of techniques that your question number three is directed. Here again I can express a good deal of agreement with much that is included in the answer of the Chairman. It is a persuasive and stimulating discussion of the issues involved. Yet there is also a good deal with which I disagree, and my conclusions as to the most effective use of open market operations, to implement credit policy and to promote economic growth and stability, diverge quite sharply from those set forth in the answer of the Chairman.

His answer, of course, is responsive to the question of the subcommittee which asked for affirmative support of the actions of the Federal Open Market Committee, to which it refers; not for the arguments for and against such action. Obviously, there is not time here for a full dress presentation of the "negative" side of the question. I should like to make certain points which I think are significant to an understanding of the problem, however, and I shall be glad to submit to the committee later, if it so desires, a written statement of views which might match the answer of the Chairman in completeness and, I would hope, in persuasiveness.

First, as a matter of background, I think I should say that I am not for pegging Government security prices nor for trying continuously to determine the structure of interest rates by means of open market operations. As one of the principals in the fight to free the Federal Reserve System from the pegging of prices of Government securities, throughout a difficult period of controversy on this point, beginning in 1946, I think I have the right to make this clear. And as one who has a great deal of respect for the operations of the marketplace, I would not want to be classed with those who believe that a continuously better result can be obtained, so far as the structure of interest rates is concerned, by completely substituting the judgment of the Federal Open Market Committee for that of the marketplace. If we want to try to find out how the patient is doing, there must be some place where we can take the patient's pulse.

Now to take up the real issues. The least controversial issue was dropping from the directive of the Federal Open Market Committee the clause authorizing open market operations to maintain orderly conditions in the market for Government securities, and substituting for it a clause authorizing operations to correct disorderly situations in the market. I voted in favor of this change, and thought it desirable not just as a question of semantics. But I would stress the avoidance of disorderly situations rather than their correction after they have happened. One of the virtues of credit control is supposed to be its ability to take prompt action to head off financial disturbances, which might otherwise have harmful repercussions throughout the economy. If open market operations in longer term Government securities can be used to this end, I would use them rather than wait until a disorderly situation or a crisis has developed and only then depart from operations solely in Treasury bills.

The most controversial issue was the instruction by the Federal Open Market Committee that open market operations must be confined to the short end of the Government security market (except in correcting disorderly situations) which, in practice, has come to mean confined to operations in Treasury bills. I did not get the impression that this action was merely an assertion of the power of the Federal Open Market Committee to determine whether and when the System Open Market Account should engage in transactions outside of the short end of the market. There need not be any question of the power of the full Committee to determine the conditions and general timing of operations in the longer term areas of the market. I was concerned with the strong emphasis which I thought was given to the permanence of the "bills only" doctrine. Suggestions for publishing a set of "rules of the game", references to a "constitution" for open market operations, and the repeated argument that Government security dealers could not create a broad, continuous market if we did not forego operations in long term securities (except to correct disorderly conditions), gave me the disturbing impression that we were in danger of placing ourselves in a straitjacket which would not permit us to accomplish what the Congress and the public might expect us to accomplish in terms of monetary management.

I, therefore, welcome the statement in the answer of the Chairman, to your question number three, that the door is being kept open to a change in the present basic technique of open market operations, and the recognition in his answer that the present approach to open market operations is still experimental and that insufficient time has elapsed to draw firm conclusions as to its performance. The publication of these views should help to dispel the idea that present techniques have been adopted for all time, and should help to avoid further hardening of the dangerous opinion that any future operations by the System in the long term market will be the signal of a critical situation.

I also welcome the repeated references, in the answer of the Chairman, to the concern of credit policy with developments in the long term sector of the market and the assertion of the particular concern of the Federal Open Market Committee that its policies be reflected in the cost and availability of credit in those markets. It has been and still is my contention that this concern can find its best expression, at times, in open market operations specifically directed at these longer term markets.

This is, perhaps, the variant approach to open market operations briefly commented upon and summarily dismissed, beginning on page 20 of the answers of the Chairman to your question number three. As set forth there, it is described as a method of operation in which "the Federal Open Market Committee would normally permit the interplay of market forces to register on prices and rates in all the various maturity sectors of the market but would stand ready to intervene with direct purchases, sales, or swaps in any sector where market developments took a trend that the Committee considered was adverse to high level economic stability."

That seems to me to be an eminently reasonable approach to our problem, but it has never really been tried - not even in the period 1951-53 to which the Chairman refers. And now it has been dismissed on what I believe is the shaky assumption that it "did not appear to offer real promise of removing obstacles to improvement in the technical behavior of the market."

This probably brings us down to the nub of our differences. The Chairman's answer to your question number three embraces the view, with which I agree, that the "depth, breadth and resiliency" of the Government securities market, or its "continuity and responsiveness", should be furthered by all means that are consistent with a credit policy of maximum effectiveness and that, in general, the greater the "depth, breadth and resiliency" of the market, the greater will be the scope and opportunity for effective credit control through open market operations. But the proof of this pudding must be found in the actual market, not in theoretical discussion of a supposedly ideal market. The answer of the Chairman asserts that the market has become increasingly stronger, broader and more resilient since the Committee adopted the "bills only" technique. It suggests most persuasively why, theoretically, this should be so. But this doesn't prove that it has actually happened. In fact, I wonder whether we are talking about the same market, and what are the definitions of "strength" and "breadth" that are being used. It is my information and observation that the market for longer term securities has remained at least as "thin", under existing open market procedures, as it was before these procedures were adopted. I think it has lost in depth, breadth, and resiliency, whether you view it in terms of dealer willingness to take position risks, volume of trading, or erratic price movements. We must not be misled by the claims of one or two dealers, who urged the present techniques, and now proclaim that they are helping to create a broader market for Government securities.

I do not think we have helped to create such a market. And, therefore, I do not see how the responsiveness of cost and availability of credit, in all sectors of the market since June 1953, can have been the result of a progressive strengthening of the Government security market growing out of the actions of the Open Market Committee with respect to open market techniques. Much of the success of System actions during this period has derived from the promptness of adaptation of overall credit policy to changes in the economic situation, and to a high degree of coordination of Federal fiscal policy and debt management with credit policy. For the rest, it has sometimes taken massive releases of reserves, under the techniques adopted or in support of those techniques, to accomplish what might have been accomplished more economically with the help of limited direct entry into the long term market.

I am hopeful, therefore, that the present period of experimentation will not be too long extended, and that we shall soon have an opportunity to experiment with the middle way - the variant approach - which I mentioned earlier.

One final comment should be made, perhaps, on the discontinuance by the Federal Open Market Committee of direct supporting operations in the Government security market during periods of Treasury financing. I would agree that the System Open Market Account should not, as a matter of routine, provide such direct support, but I would also say that we cannot, as a matter of routine, turn our back on such support.

The emphasis in the present approach to Treasury financing is good. The Treasury should meet the test of the market, in relation to other credit needs of the economy, to the fullest possible extent. But too rigid application of this doctrine is questionable, as a matter of market procedure and Treasury-Federal Reserve relationships.

In periods of credit ease, when policy considerations point to the need of keeping Treasury demands from draining credit away from desirable private use, reliance on bill purchases alone may lead to unwanted consequences. The flooding of funds into the bill market, in order to assure adequate credit in the areas being tapped by the Treasury, may produce an undue enlargement of bank reserves, or an extreme distortion in Treasury bill prices and yields, or both. There will also be times, particularly in periods of credit restraint as distinguished from the recent period of overall credit ease, when rigid application of the present rule may result in serious collisions of debt management and credit policy, which might have been avoided without jeopardizing the overall public interest.

Now let me repeat that what I have been discussing are disagreements over techniques of open market operations, not over general credit policy. It is good to have these differences opened up, and I hope that this hearing will result in more discussion of the problems involved by an informed public. We in the Federal Reserve System cannot consider ourselves to be the sole repositories of knowledge in these matters.

What I have been most afraid of is that we might come to think that we can indulge in the luxury of a fixed idea. There is no such easy escape from specific and empirical decisions in central banking. We can't have a general formula, a kind of economic law, which will serve the ends of credit policy under all sorts of economic conditions.

REMARKS OF ALLAN SPROUL, PRESIDENT,
FEDERAL RESERVE BANK OF NEW YORK,
BEFORE THE FORTY-FIRST NATIONAL FOREIGN TRADE CONVENTION
WALDORF-ASTORIA, NEW YORK CITY
NOVEMBER 15, 1954

NEW OPPORTUNITIES FOR A LIBERAL FOREIGN TRADE POLICY

I am sure that you are all aware that my role as Chairman of the National Convention Committee of the Foreign Trade Council is tinged with fraud. I have lent my name to the Committee, but my name is of little value except to me. I welcome you to this city and to these meetings, but your real welcome comes from your directors and officers who have made all of the preparations for your comfort and convenience and, perhaps, for your enlightenment. If I am to make amends for the fraudulent quality of my role, it will have to be by honesty in speech.

Given the theme of this Forty-First Annual Foreign Trade Convention, I could do no less in any case. If we are to address ourselves effectively to the general proposition that "expansion of world trade depends on international goodwill and integrity", we must be temperate but honest in our assessment of our own problems and those of our trading partners throughout the non-Communist world.

This is not always easy. The pressures of personal and group interests tend to warp the views of all of us, no matter how hard we may try to be objective in our approach to the complicated problems of international trade and finance. And the temptation is always present to tell the other fellow - or the "foreigner" - what he should do to conform to our ideas of what is just and reasonable.

I hope, therefore, that you have all been inspired, as I have been, by the truly tremendous developments in the international political sphere during the past several weeks. In a brief space of time, and hoping and assuming as we must that the various parliaments will approve what has been done, even though the debates may be sharp, we have seen what appeared to be a complete breakdown of all or most of our plans and hopes for Western Europe and the North Atlantic Community converted into a great forward step. Age-old enmities on the continent of Europe appear to be on their way to amelioration or solution, commitments have been made by Great Britain which reverse the policies of more than a century, our own nation is widening and broadening its role of partner in world affairs in a way that must help to bury whatever latent isolationism still exists, and Russian attempts to promote division and suspicion among the Western powers have been checked.

These historic developments should put a new charge of enthusiasm and courage into our attack on the economic problems which beset our world. What has been achieved in the political sphere by goodwill and integrity, and by facing the stubborn facts of a difficult situation, should make it less possible to continue to view our economic problems with such narrow perspective that caution is always preferred to daring, and the tortoise is taken right out of Aesop as the emblem of progress. I am neither proposing nor predicting a dash for free trade by the United States, nor a dash for convertibility by the United Kingdom, nor a dash by any country or group of countries away from the practical problems and real risks of commercial and financial decisions. I am saying that, in the face of this giant stride forward in our political affairs, we should proceed with better heart and greater urgency to examine critically, and with awareness of the need for mutual adjustments, the impediments and obstacles which have slowed down progress in achieving our international economic objectives.

I hope I shall not be misunderstood if most of my remarks seem to have reference to the United States, the United Kingdom and Western Europe. There will be no disparagement of the importance of our neighbors in the American continents, nor of Asia and the Middle East in such a presentation. It will represent, merely, a personal belief that the fundamental problems of international trade and finance, affecting all of the free nations, will respond most quickly to treatment at the nerve centers of trade and finance.

What have been the basic objectives of our foreign economic policy since the end of World War II? First we addressed ourselves to the relief of individuals and groups of people stricken by war - an outlet for our sound humanitarian instincts. Then we embarked on a program of economic aid to national units to help restore productive capacity and trading relationships destroyed or distorted by war - an act of enlightened self-interest. More recently the emphasis has been on military aid to our friends abroad, with whatever economic benefits might accrue - a necessary response to the menace of a totalitarian and apparently hostile force which is loose in the world. We also participated in an attempt to set up an international trade organization - an evidence of awareness that good international economic relations rest, at bottom, on good trade relations. By trying to do too much, by trying to cover countries in all stages of economic development with one set of rules, and by trying to harmonize international equilibrium and domestic stability by international agreement, this attempt courted and achieved failure. It did throw off, as a by-product, the General Agreement on Tariffs and Trade, however, which may bear the seed of greater international collaboration on trade matters and which already has some successes to its credit. As you know, an important meeting of GATT is now being held at Geneva, Switzerland, with United States representation. It is to be hoped that this meeting will have constructive results which will recommend themselves to the United States, as well as to the other participants.

And almost throughout these postwar years there has been recognition of the need to help the so-called underdeveloped countries improve their economic condition and performance - a recognition of the fact that multilateral trade concepts which rest too largely on a species of specialization which tends to freeze existing differences of skills and facilities, as between nations, are no longer tolerable. The "underdeveloped" countries want to be and should be something more than sources of raw materials for the "developed" countries.

The underlying economic goal of all of this effort has been the creation of the widest possible area of non-discriminatory trade relationships and the widest possible return to freely convertible currencies. There has been considerable progress. But I would hope that the pace of progress could now be accelerated. Even without trying to read too much long term significance into short term movements, there have been encouraging signs of the development of the kind of a trading world we have sought to achieve. And recent international political developments seem to me to have given us a new frame of reference.

Perhaps, first on the list of encouraging signs is the fact that economic readjustment in this country, which began last year, has not degenerated into a depression and has not had the serious effects on our international trade and on economic conditions abroad, which many feared and many expected. For too long we were considered to be a race of economic barbarians, given to wild and wide swings in economic activity which, because of our weight, and height and reach, endangered every other trading nation. The recession in this country which began in the summer of 1953 has been a moderate one, and already it seems to have lost its force rather than feeding on itself. We may now be regarded as a civilized economy.

Related to but also separate from this heartening display of stability on our part, has been the growing economic strength of many foreign countries. In the United Kingdom and Western Europe, in particular, economic progress has continued while we were in recession, the first time this has happened in a great many years. Production has increased, internal fiscal and monetary conditions have improved, controls including some controls on dollar expenditures have been relaxed, and a better competitive position has been attained. And despite a rise of commercial exports of the United States, and some decline in our imports, with a resultant increase in our surplus of exports, the gold and dollar reserves of foreign countries have shown a substantial gain - from mid-1953 to mid-1954 approximately $2.3 billion or 10 per cent. To be sure, United States payments for services and remittances, for military expenditures abroad, and for economic aid, contributed to this result. But without the general improvement in international economic conditions, and the greatly reduced dependence of the rest of the world on supplies from the United States over the last few years, this sharp increase in gold and dollar reserves could not have taken place.

It is highly significant, I believe, that this record has been made while discriminatory trade restrictions aimed against dollar imports were being relaxed in many countries, while international commodity markets were being reopened in the United Kingdom, and while greater freedom of dealing in various currencies was being permitted abroad. International trading has become more competitive, has been less shielded from the tests of free competition, than at any time since the end of World War II. And this testing of the economic strength of our trading partners, prior to formal and final steps of whatever character and degree into the supposedly chill waters of non-discriminatory trade and currency convertibility, reduces the risks of the final plunge and makes it that much more likely that the final plunge will eventually be taken.

It is important to emphasize this demonstration of the ability of trade and payments liberalization to go forward more or less hand in hand. We have always coupled non-discriminatory trade with currency convertibility in our prescription for international economic health. We have held, rightly I think, that currency convertibility with continued and widespread discrimination against dollar imports would be a largely sterile accomplishment, not only for us but for those who might attempt to pursue two such mismatched policies. A phony equilibrium, involving formal convertibility but achieved or maintained by quantitative controls, would be only a little more enduring than the present equilibrium of quantitative controls plus exchange controls.

While there are encouraging signs and portents, however, we can by no means conclude that all of the conditions precedent to freer trade and payments have been established. Thus far many countries, including our own, have made their contributions, each one largely in its own interest, but nevertheless contributing to the general forward movement. Yet I think there is some feeling among those of you who are interested in foreign trade and committed to a more liberal foreign economic policy that, after a magnificent start, we are now inclined to do less than our share.

Questions are raised on two main scores - our relative reluctance to invest abroad, and our halting approach to a more liberal foreign trade policy. The lesser problem of the two, in my opinion, is foreign investment. I say the lesser of the two, not because I think it is of little importance, but because I believe that questions relating to foreign investment are often based on a false assumption, and because I believe the problem has a lesser psychological impact than the problem of foreign trade policy.

The false assumption is that we are trying to recreate a past situation in which a good "creditor country" is a heavy exporter of capital to redress its balance of payments. This was a part of the combination of factors which made the mechanism of international trade and payments work comparatively well during the 19th century when the United Kingdom was the hub of world commerce and finance. It has less meaning and less force now when the United States occupies or shares that position, and when political stability around the world is more precarious. We have been described, and not wholly inaccurately, as the greatest "underdeveloped" country in the world. So long as this is so, and so long as this distinction is shared with our neighbor to the north, the competition of domestic plus Canadian investment is going to inhibit the growth of "foreign" investment. There are signs that the market for private foreign investment (I do not refer here to so-called direct investment), which has been largely frozen since the torrid twenties, is beginning to thaw a little. There is a trickle, and it should continue and grow, if the world climate gets warmer, but I would doubt that it will quickly become a torrent. And I would not want to see it forced by too much Government intervention. There are undoubtedly some things which our Government can and should do to promote private foreign investment. Perhaps the tax laws relating to such investment can be improved and perhaps some guarantees against special risks can be provided. But by and large, private foreign investment should be a matter of private risks and private rewards, with fair and equitable treatment at home and abroad the fundamental prerequisite.

Psychologically, what happens in the field of foreign investment has a lesser impact than what happens in the field of foreign trade, because the former is less in the public eye, because nobody seems to be hurt directly by its absence, and because in our thinking it is often considered to be a balancing factor after the trade returns are in.

Not nearly so much heat is generated by the failure of figures of foreign investment to come up to hopes or expectations, as is generated by trade decisions such as, for example, an increase in the tariff on dried figs or Swiss watches or the failure to award a generator contract to a low bidder from abroad. The latter incidents are commented on all over the trading world and interpreted as another sign of a return to stricter protectionism in this country.

No retaliatory moves are threatened because we don't export more capital, even though this is one of the factors behind discrimination against dollar imports.

And no domestic groups or individuals identify themselves loudly and effectively as being hurt by the failure of private funds to seek foreign investment opportunities. Apparently we can afford to get along with a gradual growth of private foreign investment, if progress is being made on the more explosive front of trade relations.

Since the end of World War II there has been no lack of organized study of our foreign trade relations, under both private and Government sponsorship. The Bell report, the Paley report, the report of the Randall Commission, and many others, have all gone over the ground, have all studied much the same facts and figures, and have mostly come up with the same general conclusions, pointing toward the desirability of framing trade policy so as to permit foreign exporters reasonably competitive access to most American markets. The fire and emphasis with which such recommendations have been made have diminished, perhaps, the closer the study group has been to Congressional attitudes, and to business and labor pressures, but whether the outcome has been a ringing affirmation of liberal trade policies, or an attempt to devise a program which would seem to have a chance of adoption, practically all of these studies have pointed in the same direction.

The net result so far has been some progress, including, more recently, holding the line against a revival of restrictionism, but now the need is to push forward with greater purpose. Now that we have pretty well accomplished the task of aiding in the reconstruction of the trading world, by Governmental gifts and loans of billions of dollars, we must overcome the difficulties of projecting a trade policy which will help to sustain what we have so greatly helped to create. I don't believe that our national penchant for "giveaway programs" extends so far as to make this our only solution of international trade problems. Surely we do not prefer to give away to foreign countries the products of our farms and factories and mines, rather than trade with them on some basis of equality? There must be some deeper force at work. I suspect that it is easier to get this great warm-hearted nation to adopt a program in which the burden is placed on all of us - as it is in the case of a "giveaway program" - than to adopt policies of trade liberalization which might, at least in the beginning, hurt some particular groups of our citizens. And the fact that with few exceptions, our national legislators are elected and re-elected on the basis, largely, of local issues rather than national or international issues, contributes to this seeming illogical result. Yet we all are aware that the "giveaway" policy is no longer generally acceptable either to those who give or to those who receive.

If we are to move ahead, new measures must now be devised and adopted. If we cannot or will not adopt policies which may temporarily hurt the few but are for the benefit of the many, had we not better give more attention than has been given to suggestions which would require the whole economy, and the whole nation, to help bear the economic pressures which might be placed on some localities, on some industries, on some groups of individuals by a more liberal foreign trade policy?

Of one thing I am pretty sure. We cannot afford to go back and we cannot afford to stand still. The twin goals of currency convertibility and nondiscriminatory trade relations have been before the various trading communities for a long time. These goals are still believed to be attainable and they still work their magic. But who can say how much longer, and in a more competitive world, the traders of other nations and the traders of this nation will submit to discrimination against their products without seeking more restrictive retaliatory action? Who can say how much longer so much of the trade of the world can be carried on with inconvertible currencies, without those trade areas which revolve around inconvertible currencies tending to fall apart? And, therefore, who can say how much longer we can expect to see progress toward a world of freer international trade and payments if these goals continue to elude us? The alternative of a United States which might be trying to rebuild barriers to imports, and of other principal trading nations of the world trying to build a permanent non-dollar bloc, is not a pretty one, but not an impossible one in the short run. And in the short run we can greatly jeopardize our chances for the long run.

As I said in a statement which your committee issued, in calling this meeting,

> "Freedom to trade and freedom to spend the earnings of trade are measures of progress in goodwill and integrity. If we and the other nations of the world reject this approach, we may well be setting a course toward insularity in trade and toward inconvertibility of currencies which it will be most difficult to alter for many years to come."

We cannot let this happen. It is time to tackle our problems of international trade and finance with the same indefatigable, patient, high level attention that has been given to our international political and military problems, and to our domestic economic program. In the present position of the United States in the world, these things are intertwined, and if we neglect one we imperil the others. It is time for a real effort on our part to make international trade something more than a step-child of domestic economic policy, and international finance something more than a step-child of domestic financial policy.

I hope, therefore, that your convention will address itself to the problems of foreign trade which it has before it, with a new fervor. In the light of recent historic accomplishments in the field of international political relations, and in the light of recent national successes in dealing with domestic economic readjustment, the impediments to a more liberal and a more stable foreign trade policy should look less formidable than they have in the past. The way is open to you to lead us in the path which we should follow.

Not to be released before 5 p.m. (E.S.T.)
Thursday, April 7, 1955.

Remarks of Allan Sproul, President,
Federal Reserve Bank of New York,
at the Sixteenth Annual Pacific Northwest Conference on Banking,
Pullman, Washington,
April 7, 1955.

Monetary Policy in Periods of Transition

My being here this afternoon is a return of the native - a native of the Twelfth Federal Reserve District. I was born in San Francisco and educated at a great sister institution of Washington State College, the University of California at Berkeley. For ten years, from 1920 to 1930, I worked at the Federal Reserve Bank of San Francisco with Cecil Earhart, Hermann Mangels, Joe Leisner, Scott MacEachron, and others you know well. In those years, during which I labored on and finally edited the Monthly Review of the bank, I came to think that I knew a good deal about the economy of this district - its agriculture, its lumbering, its mining, its fishing, its manufacturing, its transportation, and all of those diverse activities which show up in credit needs and credit extensions. I never knew as much as I thought I did, of course, because much of what I knew was second hand, but I did have a fairly good grasp of your problems and your prospects. Now, I have been too long away to try to discuss affairs which are peculiar to this western empire and which, in any case, are familiar to you. I shall seek the protective coloration of a broader canvas.

First, let me say that I was appalled when Dean Lee said that I might have an hour of your time for my talk. I realize that those who walk in academic groves regularly discharge such assignments without fear or trembling. But those of us who pound the pavements of commerce and finance are apt to find that talking for an hour stretches our powers of speech to the breaking point. We run the risk of losing both the thread of our discourse and the attention of our audience. I hope that you will bear with me, therefore, if I extend my remarks beyond the time I usually allot myself, even though I do not quite come up to the mark which Dean Lee set for me.

This matter of time has automatically chosen the topic which I will discuss. The only thing I know enough about to talk about, for the better part of an hour, is monetary policy. I thought that you might be interested in one man's view of the changes in monetary policy during the past two or three years. And then, if we have time, I could try to look ahead, not in terms of forecasting what monetary policy may be, but in terms of the factors which will help to determine what monetary policy will be.

First, let me go back to the period at the beginning of 1953, when the Federal Reserve System was following a policy of credit restraint. It has become an article of faith, with some of those who are suspicious of monetary policy, or of those who now administer it, that credit restriction at that time was the cause of the recession of 1953-54, and that the recession was an unnecessary consequence of an inflation complex on the part of the monetary authorities. We are held to be so fearful of inflation, that we forget or ignore high levels of production and employment as goals of economic policy.

Let us see what there is of truth and what there is of falsehood in these accusations. Superficially, the economic situation in the early months of 1953 did present a bright picture. Employment had reached new high levels and unemployment was at the lowest level, for that time of year, since the end of World War II. Industrial output was crowding the limits imposed by the labor force, capital equipment, and the available supplies of essential materials. Commodity prices, according to the indexes of aggregates, were stable.

One does not have to dig far below the surface, however, to find soft spots which detract seriously from this bright picture. Accumulation of business inventories was going forward at a rate which indicated that too large a part ofcurrent production was going into stocks held by manufacturers, wholesalers, and retailers, rather than into current consumption. In the second quarter of 1953, for example, such inventory accumulation was at the annual rate of about $6 billion compared with less than $3 billion in the first quarter of the year. This doubling of the rate of accumulation of inventories, which far exceeded the rate of increase in gross national product, was a measure of "false" growth. Such an imbalance between production and consumption could not go on without a breakdown sooner or later.

At the same time that this accumulation of business inventories was taking place, consumer spending was being supported by an increasing use of consumer credit which also presented elements of instability. During the year ended April 1953, the total volume of consumer instalment credit outstanding increased by $5 billion or about one-third. But even with this extraordinary addition to current income, consumer demand was not sufficient to come near to clearing the market.

Finally, the apparent stability of commodity prices, in the aggregate, was the net result of diverse movements in the prices of individual groups of commodities. Prices of many industrial goods were rising, but prices of farm products and foods were declining, a decline which reflected primarily a rate of production in excess of current demand. There was stability in the price indexes but instability in the price structure.

The choice before the monetary authorities was whether to supply the reserves which would encourage further distortions in the economy, or to try to slow down the rate of credit expansion so as to spread out the "good times" over a longer period, and reduce the danger of a later economic collapse. In the event, it was enough, and at the end more than enough, to let the pressure of demand, and of anticipatory demand for credit, press against the available supply so as to prevent the further blowing up of a "bubble on top of a boom". Of course, there was no check plot to tell us what might have happened if we had not pursued the policy we did in early 1953. But I find it beyond belief that an easy money policy in the boom atmosphere of the period would have made it possible for the country to avoid a recession in 1953-54, and to avoid even mild adjustments of that magnitude for the indefinite future. Such a belief would fly in the face of all that is known about the way changes occur in a dynamic enterprise economy.

It is also held against us, however, that other forces were already in motion, early in 1953, which would achieve what we sought to achieve. Specifically, it is said that it was obvious at the beginning of 1953 that there was going to be a substantial decline in defense spending later in the year which, unless offset by an increase in private spending, would seriously and adversely affect the whole economic situation and that, therefore, a restrictive credit policy in early 1953 was untimely.

Now there may have been some knowledge and, as I recall, there was some guessing in the latter part of 1952 that the peak level of defense spending would be reached sometime around the middle of 1953. But later official statements and budget forecasts or projections moved the peak of defense expenditures out beyond 1953. The budget which was prepared by the outgoing administration, and sent to Congress early in January 1953, called for a further increase in Government expenditures, and indicated a budgetary deficit of $10 billion and a cash deficit of $6.6 billion, during the fiscal year 1954, the largest such deficits since World War II. Even though some economies were begun in early 1953, and even though greater economies were achieved than was then estimated, actual defense expenditures continued to increase through the second quarter of 1953 and, even in the fourth quarter of that year, were only slightly less than in the first quarter. There was no clear and definite projection of defense expenditures which might have guided monetary policy along another path than the one it took.

It is probably not necessary to argue, however, what could be seen in the crystal ball, in early 1953, so far as future defense expenditures were concerned. The prospects for a truce in Korea improved as the spring advanced, and it became reasonably certain that, in the absence of major fighting elsewhere, the longer run level of defense spending would be below the high levels of the first half of 1953. But the likelihood of a decline in defense spending by the Government, at some future time, was not a good reason for abandoning credit restraint in early 1953. Rather it counseled against letting unrestrained private spending compete with defense spending under the conditions then prevailing. If business inventories and consumer credit had been encouraged to expand without restraint at the same time that defense expenditures were rising to a peak, and private capital formation was proceeding at record levels, the dangers of the prospective decline in defense spending would have been increased. The economy could have gotten way off balance, and really reacted dangerously when defense spending did decline. This was a threat which a policy of credit restraint in early 1953 helped to banish.

That policy may not have been perfect in its timing and its execution, and it was not popular. A policy of credit restraint seldom is popular, and unpopularity breeds misinterpretation and attack. I have mentioned the assertion or claim of our critics that the economic situation in the spring of 1953 was close to ideal, in terms of production, employment, and prices, and that our unnecessary intervention was the result of an inbred fear of inflation. I suppose we central bankers are partially responsible for this sort of opinion. We have long been distrustful of our own ability to help check a decline in economic activity, once underway, and have frequently argued that monetary policy could be most useful in checking the excesses of the later stages of a boom, thus helping to prevent or diminish the agonies of the "morning after". This may be twisted into an inflation complex. Is it not clear, however, that our underlying concern, in such circumstances, is actually with deflation not inflation? We fear deflation more than inflation, just as do most people who are aware of the human aspects of economic forces, and the human suffering which is involved in both of these deviations from economic well being. If, at times, we apply measures of restraint to a bubbling economic situation, it is because that is one of the reasons for our being - to try, during periods of high prosperity, to help prevent the excesses which will bring such periods to a destructive end.

I might even go beyond that position, and say that there is another reason, in our present state of economic development, for a body which has a sound and healthy concern about inflation. That is the strong pull in the other direction, which gains power from a host of politicians and large groups of our population, and which does not lack economists and pseudo-economists to bring it intellectual support. The Employment Act of 1946 is now the main guide of public economic policy. The danger is that this call for Government action to promote maximum - not full - employment, production, and purchasing power will be interpreted to mean that monetary policy should embrace creeping inflation, so as to create conditions which are said to be necessary to the promotion of "full employment", no matter what happens to the purchasing power of the dollar. Recently, before a Congressional committee, I said that those who would seek to promote "full employment" by creeping inflation, induced by credit policy, are trying to correct structural maladjustments, which are inevitable in a highly dynamic economy, by debasing the savings of the people. If their advocacy of this course is motivated by concern for the "little fellow", they should explain to the holders of savings bonds, savings deposits, building and loan shares, life insurance policies and pension rights, just how and why a rise in prices of, say, 3 percent a year is a small price to pay for achieving "full employment". They should also explain to all of us - little, big, and just plain ordinary Americans - what becomes of our whole system of long term contracts, on which so much of our economic activity depends, if it is to be accepted in advance that repayment of long term debt will surely be in badly depreciated coin.

No, I say it is necessary and wise that the monetary authorities not accept the questionable dictum that high level employment and price stability are necessarily incompatible. It is probably true that full employment, in the sense of there always being "more jobs than men" may not be possible without creeping inflation. Such a condition implies sellers' markets, not only for labor but also for raw materials and finished goods. It implies a situation in which efficiency incentives are reduced and there is weak resistance to increased costs, since such increases can usually be passed on in higher selling prices. These conditions are not likely to be conducive to maximum economic progress. Laxity of effort and speculative sprees develop in such an atmosphere and lead to distortions and instability, rather than to sustained accomplishment. But a condition of high employment, high efficiency, high production and stable values seems to me to be a feasible and desirable objective.

Such an objective suggests that we need to give more attention than we have done to the division of the rewards of increased productivity. In recent years, loud shouting has made it seem as if the only question was whether "big labor" or "big business" was to reap the lion's share. It is clear, I think, that we are going to have to get along with "big labor" and "big business". One is the product of the other, and both have had a part in the tremendous increase in our productivity as a nation. It is a cliche, a truth worn bare by constant repetition, that our American system of production has brought greater material well being to more people than any other economic system yet devised. But that system may not maintain its place indefinitely, if there is persistent inequity in the distribution of its rewards. If owners and managers or organized labor, or both of these groups, take unto themselves too large a share of the rewards of increased productivity, the economy may eventually be retarded. One danger is that, if all the gains of increased productivity go to raise profits and wages in the particular industries in which the increase occurs, a wave may be set in motion which will spread to all industries, including many where there has been no gain in productivity. That throws the economy out of kilter, and is one of the sources of the demand for continuous "gentle inflation".

There is the even greater danger that the consumer, the fellow on whom we all depend to keep our economy going, will be squeezed or forgotten by the power blocs. He needs to be considered, along with the more privileged groups, because he is all of us. He should get his share of the dividends of increased production and improved methods, in the form of lower real prices. If he doesn't get his share, the end result, despite his capacity for long suffering, is likely to be political action to restrain "bigness" in industry and in labor. And such action may be blundering and punitive. The tendency toward an absence of price competition in large segments of our economy, suggests that we need to review a good deal of our thinking regarding the competitive free enterprise system whose benefits we all enjoy.

This is a concern of monetary policy, because lower real prices, in an economy of increasing productivity such as ours, are a function of stability of the dollar. And stability of the dollar, along with maximum production and employment, is a primary objective of monetary policy. We need the best fusion of these objectives which we can get. Then if, from time to time, our dynamic growing economy throws so many people out of work as to be socially intolerable, we should seek further means resting on the whole economy to take care of the situation. But we should not debauch monetary policy trying to make it do the whole job, by way of creeping inflation. We shouldn't steal the savings of the people with one hand, while we promise them steady work and a comfortable old age with the other.

Now to return from that partial digression. When we come to the change in monetary policy in May-June 1953, from restraint to ease, and later to "active ease", we come into a period when monetary policy could bask in the approval of almost everyone. It was said that we were prompt in action and vigorous in execution and, as a result, we have been given some credit for the mildness of the recession which began in the third quarter of 1953 and which has now been largely corrected. Modestly, or as modestly as we can, we accept this praise while, at the same time, we carefully point out that monetary policy, as always, was only one factor in a complex situation, and while we privately admit that luck was on our side, too. We need to avoid being asked to carry burdens which we cannot bear, and we need a little luck if we are successfully to carry the burdens which we should bear.

In any event, we were doing the popular thing when we created and maintained easy money during the last half of 1953 and all of 1954. We even surprised ourselves a little, because monetary policy was not so helpless as a good deal of theory had suggested in checking recession and providing a positive stimulus to recovery.

As was stated in the recent annual report of the Federal Reserve Bank of New York for 1954, the buildup of business inventories of 1952 and the first half of 1953, gave way to inventory liquidation in the latter part of 1953 and most of 1954, and the end of the war in Korea in July 1953 was followed by cutbacks in defense expenditures. Industrial production and employment declined, and demand for raw materials and finished goods, both domestic and imported, decreased. In this situation, the principal objective of economic policy was to prevent the unavoidable corrective adjustments from feeding on themselves and cumulating until recession became depression, and to give encouragement to the forces of recovery. Prompt response to the evidence of slackening output did not require extreme intervention by Government, however, since the natural forces of recovery within the private economy were strong. The role of monetary policy, along with fiscal policy, was one of softening the impact of the adjustments which were taking place, and exerting an overall influence which would encourage the flow of resources, manpower, and credit into areas where the potentiality for expansion was real.

A recovery so induced was likely to be more lasting than one too heavily dependent on artifical stimulants, such as more direct Government intervention. The easy money policy of the Federal Reserve System made its contribution to recovery by relieving pressures for forced liquidation, facilitating an orderly readjustment of surplus stocks, and in general making sure that ample funds were available for both short term credit and long term capital needs.

The principal burden of sustaining this policy was borne by open market operations, the name given to purchases and sales of Government securities by the Federal Reserve Banks, which put reserve funds into the banking system or take them out as the needs of the economy seem to require. Throughout this period, we exerted pressure on the banking system to find outlets for excess funds, by maintaining a substantial volume of free reserves, that is, excess reserves less borrowings from the Federal Reserve Banks, in the hands of member banks. As a consequence, total bank credit expanded more rapidly than in any year since World War II, despite some repayment of business borrowings as a result of inventory liquidation and the end of "tax borrowing" with the expiration of the excess profits tax. Other types of loans increased, and there was a large increase in bank investments, which either financed public and private expenditures directly or provided funds for investment by others.

There was, of course, considerable interplay between open market operations, a mid-1954 reduction in reserve requirements, and discount rates. The discount rate was reduced twice, from 2 to 1 3/4 percent in February 1954 and from 1 3/4 to 1 1/2 percent in April. The discount mechanism, however, was largely put out of commission by the general policy of maintaining a considerable aggregate of "free reserves" in the banking system at all times. Relatively few banks found it necessary to borrow from the Reserve Banks, and then only for short periods for temporary reserve adjustment purposes. Reserves were obtained more cheaply and in more permanent form by the reduction in reserve requirements and through System open market operations. Under these conditions the discount rate became primarily a symbol of the direction of System policy, and a pivot for certain other short term money market rates, not a main determinant of credit conditions.

To sum up, and again drawing on the recent annual report of the Federal Reserve Bank of New York, flexible credit policy was employed in 1954 to provide an abundant supply of cash and credit to the economy and, in coordination with other instruments of economic policy, to help halt and then reverse the recession which had gotten under way in mid-1953. The recession was halted and reversed and, by the end of 1954, recovery was well under way. The available statistics indicate that this recovery was based, in considerable measure, on extensive recourse to credit, but that is not to claim, of course, that easy money, by itself, brought about the recovery. The underlying soundness and strength of the economy was the necessary and vital ingredient.

Looking at both 1953 and 1954, I believe it is fair and reasonable to conclude, on the basis of the evidence, that credit policy was effective and contributed positvely to economic stability and long term growth, both when it restrained the excessive use of credit and encouraged postponement of some capital projects prior to mid-1953, and when it eased conditions in the credit and capital markets in the last half of 1953 and in 1954.

All of this is economic history which will quickly become ancient, however, and probably much of it is as well known to you as to me. All I have tried to do is to bring into clearer focus a few main elements of the picture as I have seen it develop, in the hope that it would be of some interest to you, not only as an aid to understanding the past but also as a guide to the future. As bankers, businessmen, and even as economists, I am sure that you find guessing what the future may hold a more fascinating and, at times, a more profitable form of mental exercise than dissecting the past.

Unfortunately, perhaps, that brings us into a time period in which I can be less positive, less cock-sure, and certainly less authoritative than when talking about what is past. And I have to warn you, at once, that nothing I now say can be taken as an exact statement of present System views or policies, nor as a forecast of what System views or policies may be in the future. I shall be giving you my views and opinions, which may or may not be shared by my associates in the System. The System is not a monolithic organization - we have disagreements without purges. Fortunately there has most often been a clear consensus as to what policy should be, even when we have disagreed sharply as to operating techniques.

Perhaps the best way to go about this excursion into the future is to start from a known point. The policy record of the Federal Open Market Committee, recently published in the Annual Report of the Board of Governors for 1954, confirms a shift in monetary policy which took place in December 1954. Whereas during the previous year we had been conducting open market operations with a view, among other things, to promoting growth and stability in the economy by actively maintaining a condition of ease in the money market, we then decided to take the "active" out of ease.

This shift in the degree of credit ease to be maintained seemed to be in accord with the economic developments of the last quarter of 1954 and the near term prospects for 1955. With the recovery movement pretty firmly established, although by no means complete, it seemed appropriate and desirable to take out of the banking system the surplus funds which had been used to keep up the pressure on banks to loan and invest. As demand for credit grows, with reviving business, the existing money supply will be used more actively - its velocity will increase - and the need for pressure to bring it into use will decline. Nevertheless, this shift in policy has been challenged, and again the criticism has been made that our fears of inflation - which seems to be narrowly defined by these critics in terms of the movement of prices - have led us into actions which may jeopardize the present business recovery. So far, I think you will all agree, the recovery shows little or no sign of being "jeopardized". It is a pretty vigorous affair. But if it does not come up to the mark of the builders of statistical models of what a fine world this could be, I am sure we shall be blamed.

What has been done, primarily, was to mop up an overhang of excess funds in the banking system which needed to be removed, so that the relation between business expansion and credit expansion would be better observed and better coordinated as the recovery progressed. This was "taking up the slack". It cleared the way for observation, analysis and interpretation of those broad general trends in the economy which, I think, can give a lead to credit policy in a recovery period.

What are some of these trends? First, there is the character of the business recovery. Is it widespread or heavily concentrated in a few industries or areas, balanced or distorted? Is it so rapid as to make it unlikely that its pace can be sustained, thus raising the question of another setback? Is it so slow that, even if continued, it will leave us with the problem of a labor force which is growing more rapidly than the increase in jobs?

Second, there is the appearance or non-appearance of speculative tendencies in business plans, in consumer buying, and in public or mass reactions to the sweet music of recovery. How are prices behaving; are there sharp advances in basic commodity prices which seem out of line with increases in production and consumption? Is there evidence of inventory accumulation beyond the needs of a prompt delivery economy? Is the economy on a prompt delivery basis or are bottlenecks appearing? Is there an absence of resistance to higher costs, on the assumption that they can readily be passed on to the consumer? Do business plans for capital expenditures seem to be in reasonable relation to longer term growth? Does the consumer seem to be showing signs of going on a spending spree, stimulated by increasing injections of instalment credit? Is the construction industry wearing out the effects of very liberal mortgage terms, originally abetted by a monetary policy dedicated to easy money? Is the stock market getting into the taxicab, the elevator, the barber shop and the front pages of the newspapers, instead of staying where it belongs as a necessary adjunct of our financial and investment machinery?

Last but not least in this brief catalogue, there is the rate of growth and use of credit, and of the money supply. Does available bank credit appear to be insufficient to nourish a vigorous recovery? Does it appear to be readily available to facilitate sustainable economic growth? Does it look as if it might be in excess supply, encouraging a speculative spirit, or, to change the metaphor, sowing seeds of inflation which could lead to another economic downturn?

Obviously these are very general criteria. But they are the kind of criteria which, along with the masses of statistics that underlie them, and all the general information which defies statistical compilation, we have to try to interpret and digest in reaching judgments as to monetary policy. There are no specific criteria which can guide the policies of the Federal Reserve System at all times. There are no clear and definite trigger points which will tell you exactly when to shoot and when to hold your fire. We must rely on general criteria and use many guides to judgment and action, and you will have to do the same in guessing what our actions may be and judging them after the fact.

It may be possible to indicate some of the things which might conceivably come about in the monetary sphere, however, if economic recovery continues along a healthy course, and if there are no international developments to upset, seriously, our domestic tranquillity. I do not treat the latter hazard lightly. It is the over-riding question of our time, no matter how small the sector of the landscape we are surveying. But I do not have the means of assessing the possibilities and probabilities of war.

If war is to be avoided and if economic recovery continues, these things might occur. There should be some revival of discount operations at the Federal Reserve Banks. The discount window was largely put out of commission during the period when reserve funds were being pushed on the banking system by a combination of open market operations and reductions in reserve requirements. Individual banks in adjusting their reserve positions, and the whole banking system in meeting seasonal or other less than permanent needs for reserves, may now become more dependent upon borrowing at the Reserve Banks. This will be healthy and useful. The volume and persistence of such borrowing could give some indication as to whether credit policy is geared to a generally healthy recovery, or is too restrictive and thus checking recovery, or too liberal and thus endangering the longevity of recovery by promoting speculative uses of credit. If the signal seems to be that credit policy is becoming too restrictive, relief can be given quickly by open market purchases of Government securities. If the signal seems to be that credit policy is becoming too liberal, open market sales would have the reverse effect.

Second, in such a period of recovery, and with even the mild shift in credit policy which has taken place, it would be expected that some rise in interest rates would occur. In fact, as you know, there has already been a rise in interest rates, proportionately greater at short term than at long term, but extending out through the whole range of debt maturities. Commercial banks, which were active purchasers of marketable securities at short, and then at longer term, during the period of very easy money, find their resources adequate to meet actual or prospective increasing demands for loans, but not so large as to press continuously for investment outlets. A moderate firming of interest rates during a period of economic recovery is to be expected and can be constructive rather than a damaging influence.

The movement of interest rates during recovery will have to be watched more closely, however, than in the preceding period of recession, when nearly all of the emphasis was on the availability of reserves, and when what happened to interest rates was of relatively little concern to the monetary authorities. Interest rates have now become one indicator of the degree of credit ease or tightness which is being maintained by monetary policy. A rise in interest rates which went too far too fast could be damaging, particularly in the capital markets where a continued flow of funds into capital expenditures is desirable.

Third, changes in the discount rates of the Federal Reserve Banks might be made more frequently in such a period, as the discount window of the Banks again became busy, and as interest rates become more sensitive indicators of market pressures. In such circumstances, the discount rate could assume the role of an anchor for the whole structure of interest rates. And eventually it might lose some of its ponderous significance as a symbol, while it gained in power as a ready weapon of monetary policy.

I do not know quite what to say about the money supply, because it has suffered at the hands of those who have mechanistic ideas about monetary policy. Certainly the money supply - usually defined as currency outstanding plus adjusted demand deposits - will bear watching, but it is difficult to establish it as a gauge of monetary policy in a period of business recovery. Private demands for credit are expected to grow, in such a period, at a more rapid pace than would result solely from seasonal or secular influences. But this might or might not be reflected in a comparable increase in the money supply. During some of the stages of recovery, the economy may not need an increase in the money supply, because of more effective use of the supply already in existence. Over the recovery period as a whole, however, there should be an increase in the money supply. But I don't think you can be precise about the amount or the percentage of increase. You can't rely on the money supply figures automatically to tell you what to do and when to do it.

As you can see from this hasty summary of some of the general criteria of monetary policy, and of some of the things which might happen as a result of a monetary policy geared to economic recovery, we central bankers are practicioners of an art, not a science. In practicing that art we can never lose sight of the broad purpose of our being - to help to maintain those conditions in the economy which will promote high levels of production, employment, and consumption, and stability of the purchasing power of the dollar. This demands flexibility. It demands restraint upon the use of credit when the economy begins to stretch at the seams, and credit is being called into use to support too many speculative positions, as well as the production, distribution and consumption of goods and the provision of needed services. It demands encouragement of the use of credit, when our productive resources of men and machines are not being utilized as fully as they should be. It demands that actions be taken with a view to accommodating the needs of the whole economy, in the public interest, and not the needs of special groups or interests, whether they be economic groups or political interests.

That is a large order. I cannot claim that we have either the technical means or the ability to fill it to the satisfaction of everyone, including ourselves. We need all of the advice and counsel we can get, from bankers and economists meeting in groups such as this, from farm groups, labor organizations and business groups, and from those who occupy places of responsibility in the apparatus of Government. In return we have a right to ask that the advice we are given be as objective as possible, that criticism be as constructive as possible, and that our integrity and our honor not be impugned in the process. We are not the vassals nor the pawns of any vested interest. We have taken a binding oath to serve the interests of all of the people of the United States to the best of our ability. We have no other purpose.