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Remarks of J. L. Robertson,

Member of the Board of Governors

of the

Federal Reserve System

in connection with the dedication

of the enlarged

Federal Reserve Branch Building

at Omaha, Nebraska

November 7, 1957

We are here tonight to help celebrate and dedicate the fine new addition to the Omaha Federal Reserve Branch. It is no secret that I was reluctant to give my approval to remodeling this building. I would have preferred to have the old building torn down and a magnificent new one built in my home town - Broken Bow, Nebraska - more nearly the heart of this district. However, for some strange reason my associates were not overly enthusiastic about Broken Bow as a branch site - after all, as one of them pointed out, there is not even one member bank there. Consequently, I accepted the second best solution - remodeling and enlarging the Omaha branch. But all of us can agree it has turned out extraordinarily well. It has been said that "the best fertilizer on the land is the master's footprints". One can see the master's footprints all through this new building.

This branch, together with twenty-three other branches in major cities, the twelve Federal Reserve Banks, and the Board in Washington, constitute a unique institution. The Federal Reserve System, which Congress created and to which Congress entrusted the power of money management, is a blend of public and private interests. The Board of Governors in Washington is, as you know, a government agency; although independent, it is independent within - not outside - the government. The Reserve Banks and their branches are quasi-public institutions, subject to the regulations and supervision of the Board but guided by their own boards of directors, two-thirds of whom are selected by the member banks of their districts. In a real sense, therefore, the member banks are a part, and an important part, of the central banking system in the United States.

Of course, there are important differences between the purposes and functions of the central banking system and the commercial banking system. The central banking system is in a way a bankers' bank - performing for the commercial banks functions similar to those the commercial banks perform for their customers. But unlike the commercial banks, profit is not a central bank's objective.

And there is a somewhat related matter I should like to clear up - I wish I could say "once and for all": the Federal Reserve Banks do not compete with commercial banks for correspondent business. Officers of some larger banks used to think they did, and in some cases, without explaining why they retained membership, counseled smaller banks not to join the System. Today, I am glad to say, only a handful of unenlightened bankers follow this shortsighted practice, and by and large they are the same ones who entertain the erroneous notion that the Federal Reserve maintains itself by investing member bank reserves in government securities.

Today all bankers know - I hope - what the purposes of the System's operations are: to maintain an adequate - but not excessive - supply of money and credit, and to facilitate the efficient operation of our financial system.

In spite of the differences between the commercial and the central banking system, they are partners in a function of unparalleled economic importance. They are partners in operating the monetary system of the United States. Together they exclusively create and control the money supply - not only coins and paper currency, but more importantly, check book money, deposit money. Other institutions, which gather savings and relend them, also play a significant role in our financial system, but in carrying out their transactions they must use the money that our partnership creates.

There is no question about the fact this power we share is a very special one. History reveals that the power to create money can be - and has been - a vital force for either good or evil. The power to create money can be used constructively to promote economic growth by providing funds for expanding productive facilities and by financing the efficient operation of a complex economic machine. In this way it helps to achieve the goal of all economic activity - namely, rising living standards. On the other hand, the power to create money, if it is misused, can lead to economic and political chaos. It is the purpose, and the firm purpose, of the Federal Reserve System to use its power over money creation to try to maintain a stable value for the dollar while encouraging steady, sustainable economic growth. I know that this objective is also cherished by the commercial banking community.

It is very easy to use clear, resounding phrases to state our purposes - a stable dollar, steady economic growth, and the highest level of employment compatible with a stable currency. Everyone is for progress, everyone is for growth, and almost everyone wants stable prices. There is unlikely to be much argument or protest in response to a statement of these broad goals of monetary policy. In other words, people do not argue about the menu, although they may complain about the meal that is served. This may not be an appropriate analogy after the dinner we have enjoyed, but it illustrates my point - that general agreement about the goals of monetary policy leaves much room for misunderstanding and disagreement regarding its operations and effects.

I repeat: our partnership has great powers for good or evil; what it does, or fails to do, affects the welfare of all Americans, and the welfare of the people of other countries as well. But in doing its job it is severely hindered by the fact that the operation of monetary policy is so little understood by the general public.

Better public understanding is necessary for the obvious reason that an informed citizenry is essential to the success of democratic institutions. Furthermore, the effectiveness of monetary policy would be enhanced if it were better understood. When a veil of mystery surrounds monetary policy, there is a danger that public psychology will magnify a molehill into a mountain. In those circumstances public reaction to changes in economic activity and in monetary policy can be exaggerated and unpredictable.

It should be admitted, candidly, that part of the reason for lack of public understanding is that monetary policy has not been completely successful in achieving its goals. Although we strive continuously for a stable dollar, we <u>have</u> had inflation. In the past two years consumer prices have increased 5-1/2 per cent after several years of stability.

With prices rising, the critics of monetary policy - and, as you know well, there are such critics - can legitimately ask: What good does monetary restraint do? And the man in the street - that often-quoted gentleman (or lady) who is so difficult to find - is understandably confused. How does it happen, he might ask himself, that the prices I pay keep advancing in spite of all the talk about maintaining stability through credit restraint and rising interest rates?

If the man in the street understood the monetary mechanism as well as he understands the mechanism in which he drives to work, he could answer this question for himself. He is not confused by the fact that his car continues to move forward even after he has applied some pressure to his brakes. This does not lead him to the conclusion that his brakes do not work. He knows very well that his brakes enable him to slow down when necessary. He also knows that if he steps on the brakes too hard and too suddenly he and his passengers might go through the windshield, or if he does not step on them at all they might go through somebody else's windshield.

In trying to combat the inflationary pressures of recent months, the System has used the brakes but it has not shifted gears into reverse. The signs were not sufficient to warrant such an action. In view of the price advances we have had, it may be that the brakes should have been applied more heavily in the early stages of the boom.

Be that as it may, it is both evident and unfortunate that we - and I mean us in the Federal Reserve System as well as you in the commercial banking system - have not done an adequate public relations job in acquainting people with what monetary policy is all about.

It is not necessary that we try to make every American a monetary expert. There are many technical aspects of this field that are better left to the technicians - just as most of us leave knowledge of the intricate workings of our automobiles to experts in that field. We do, however, understand enough about our automobiles to know both their capabilities and their limitations. It would represent a significant advance if there were greater public understanding of the capabilities - and the limitations - of the mechanism that controls the money supply.

Control over the creation of money is, of course, not the same thing as control over our economic system. For the most part, our economy functions without central direction and control. Decisions to consume and produce, to invest and to save, to buy and to sell are made independently, on the basis of their own private interests, by workers, businessmen, and farmers, all of whom are also consumers. It is precisely because decisions to spend are made by millions of individual family and business units, as well as governmental units, that spending sometimes increases faster than the goods and services available for purchase. If that happens when there is little margin of labor and productive capacity for further expansion, something has to give. What tends to give is the level of prices. The amount of goods and services does not increase - since you cannot squeeze water out of a stone. Their price simply goes up until it equals the amount people have decided to spend.

Once this process of price inflation starts it tends to accelerate. Wage demands begin to reflect the increase in prices, and successful wage demands are in turn often reflected in price increases. Decisions are made to spend, and to hold larger inventories, in anticipation of higher prices. Farm land prices continue to rise despite declining farm income. The process becomes pervasive and cumulative.

The role of monetary policy in these circumstances is to prevent or at least restrain this inflationary process by patterning the coat to fit the cloth. Monetary restraint attempts to maintain growth in the economy at stable prices by limiting the amount of bank credit so as to keep it in balance with the supply of goods and services. History, as well as economic theory, demonstrates that unless restrained in this way, an inflationary boom will end in a serious depression.

However, our power to prevent booms and busts is not without its limitations. We cannot control public psychology, spending habits, savings habits, public debt, government budgets, or special pressures from labor, agriculture, and industry that result in excessive wage and price increases and government guarantees of one sort or another. In fact, the spending or savings habits of people determine the velocity of money, which has a decided bearing on the amount of purchasing power chasing goods and services. The effect on prices is obvious. A five dollar bill spent twenty times has exactly the same purchasing power as a hundred dollar bill spent once. Excessive or improvident spending by people or by government (local or national) can thwart the best formulated monetary policy. The most the System can do is to attempt, through regulation of the money supply, to provide conditions which are conducive to economic stability.

Some of you probably have children who, like my own, have engaged in the raising of tropical fish, and consequently, you have learned through hard experience, as I have, that the health, clarity, and beauty of the aquarium is dependent upon the maintenance of a proper balance of four factors: water, fish, snails, and vegetation. When a proper balance is maintained, the water remains clear and the fish healthy, but, if those elements get out of balance, the water becomes cloudy and the fish start turning over on their backs. All factors except the plant life are untouchable; the aquarium is only so large, so the volume of water cannot be altered and one cannot control the increase of fish or snails without committing murder, which is unthinkable as far as the children are concerned. Therefore, one tries to develop an ideal environment by regulating the plant life - taking some out and putting some in as conditions warrant.

There is a slight analogy between the aquarium and the economy, even though not between fish and people. Whereas the plant life is the factor we can control in the aquarium, in the economic field the variable under System control is money and credit. In each case, the objective is a healthy environment, either aqueous or economic, and there are no precise formulas to measure in advance the appropriateness of a given action. In either case, the interference should be kept to a minimum - certainly in the case of the aquarium too much interference will cause the fish to become neurotic and unhealthy.

Realization that it controls only one factor among many contributes to a suitable humility in the Reserve System - an understanding that even the most skillful regulation of the money supply cannot by itself assure economic stability and growth, but only provide an environment that is conducive to it.

In a dynamic economy, we can never achieve absolute stability of prices or straight-line productive growth. Neither monetary policy nor any other policies can keep the economy on a perfectly even keel at all times. In an economy as dynamic as ours we have to expect our rate of growth to vary. We have to expect occasional lulls in the pace of advance. Similarly, if we are to have a dollar of stable value - and thus protect and encourage the savings on which growth depends - we should expect times of rising prices to be followed by periods in which prices move down.

During recent months, as I indicated earlier, Federal Reserve policy has operated like a gradual pressure on the brakes, not like a roadblock. In stepping on the brakes - or the accelerator (under different conditions) - the pressure applied is seldom just right, when viewed from hindsight. While great effort is made to gather and analyze the economic and financial information that seems pertinent to our task, the people who formulate monetary policy are subject to the same limitations of judgment and the same inability to predict the future that characterize all human beings. We are far from infallible. This, too, should be understood by the public. But we like to think that the excellence of our fact-gathering and analysis makes it possible for us to keep such mistakes to a minimum.

You probably know, but others do not, that our decisions are not made on the basis of either politics or chance guesses. Unlike the Deity in "Green Pastures", we do not merely "rare back and pass a miracle". Let me enumerate some of the kinds of economic information which form the basis for our actions. At the end of every business day there is placed on the desk of each Board Member a report from our staff on the course of the government securities market on that day, together with a tabulation of all major factors - and changes therein - affecting the national money market. These comprise only two pages, but they represent a great deal of high-speed, high-tension work by a group of exceptionally capable economists and observers.

Each of us also receives daily a longer report from the New York Reserve Bank which could almost be said to hold the pulse of the money market twenty-four hours a day, every day in the year. That report gives us detailed information regarding the reserve position of the New York City banks, the money market operations of the Reserve System, the government and corporate securities markets, money rates, foreign exchange, and so on.

We also receive weekly and monthly reports and summaries of such matters as the averages of member bank reserves and Reserve Bank credit; the condition of member banks in leading cities; the condition of all banks in the country; the trend of deposits, loans, and investments; banking and monetary developments during the preceding period; gold inflows and outflows, etc.

The facts and figures that reach us are not confined to money market matters. At weekly intervals the Board sits around the table with the top members of our research staff and reviews the latest economic developments: industrial production, employment, distribution, prices, agriculture, bank credit, business finance, consumer finance, construction, housing credit, security markets, foreign trade, and conditions abroad.

And constantly before us, on the walls around the Board room in Washington, are a dozen major charts, kept currently up to date, which seem to me to summarize the economic condition of our country more graphically and understandably than any other group of data of comparable size.

Every three weeks the Presidents of the twelve Federal Reserve Banks report to the Open Market Committee on the economic conditions in their districts based on their own observation and that of their economists and the directors of their institutions.

I have enumerated some of the types of information upon which decisions are based in an effort to indicate the Reserve System's realization that intelligence and judgment are of little value in this field without a solid foundation of fact, just as any factual data is worth little unless it is interpreted and applied with judgment, integrity and courage.

All these facts, then - compressed, and brought into focus by the comments and views of our staff - flow in a continuous stream over the desks and at the daily meetings of the Board of Governors and the tri-weekly meetings of the Open Market Committee. Preparing for these meetings involves a great deal of homework for each of us. Every important decision of the Board and of the Open Market Committee is participated in by every available member. And as you may have heard, the participation is so individual and intense that occasionally it verges on the acrimonious! I, for one, do not regret that feelings sometimes run high at our meetings. It seems to me that this reflects an awareness of the significance of our work - that our decisions, right or wrong, have an effect probably unique in magnitude, whether for good or ill, upon the prosperity and economic progress of the nation.

It is important that the public have a better understanding of the significance of the monetary system to the national welfare - of the role that it plays in the lives of all of us. It is particularly important in a period when inflationary pressures are dominant and a policy of credit restraint is necessary, for at such times there are always powerful groups that feel the pinch and try to whip up opposition to policies, however sound, that may cramp their style.

The task of bringing this about is difficult for, in the best of circumstances, there is an emotional resistance to such an understanding. As one of the world's foremost central bankers said recently: "Who would not like a world of peace and plenty, with full employment, with no shortage of housing, of schools and hospitals, no shortage of radios, cars and televisions, no shortage of roads and bridges and tunnels, no shortage of capital and equipment, and last but not least no less developed neighbours who are a weight on one's conscience and a threat to one's safety? Who wants to be constantly reminded that all these desirable things can only be had at a cost and that to strive for them by spending more than one's real resources will only lead to one's own destruction? It is the dismal duty of a central bank continually to preach this gospel of sobriety and, more than that, to try to enforce it by its policies."

This duty is not for the central banker alone; it is a job that must be done by both partners. The commercial banker has an equal stake, an equal interest in the welfare of our country. And it is a job well worth the doing, for if, by our joint effort, we can bring about a better public understanding and enhance the effectiveness of monetary policy in its job of maintaining our nation's financial "sobriety", it seems evident that apart from occasional lulls our economy can remain dynamic and continue to follow an upward path, on a stable basis, that will provide constantly better living standards for the American people - and, we should remember, that is our ultimate goal.