For release 8:00 p.m.
Central Standard Time
November 21, 1963

Remarks of J. L. Robertson

Member of the Board of Governors
of the
Federal Reserve System

at

Dinner Meeting Held in Connection with
the Joint Meeting of the Directors of
the Federal Reserve Bank of Chicago and
of its Detroit Branch

Chicago, Illinois

November 21, 1963

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The Challenge of Change

Recently I was impelled to look back over the record of the last dozen years - the years of my service on the Board of Governors. I was impelled partly by curiosity and partly by a desire to test in some way whether the past really is prologue. To begin with, I browsed through my public statements. The sheer volume was shocking, but what truly amazed me was the ever-present evidence of change in the world about us. The only thing that remained constant was a reference of some sort to my home town - Broken Bow, Nebraska; it was the single unbroken thread running through all of them.

When I first came on the Board, a dozen years ago, we had an inflation on our hands at home and a hot war abroad, Joe Louis was heavyweight champion of the world and Jack Nicklaus was still in grade school. The Dow Jones average ranged around 260, about one-third of today's level, and the GNP was only $350 billion, a little more than half of what it is now.

The relationship among the federal bank supervisory agencies was cooperative and harmonious; at least their officials were still on speaking terms. It was unimaginable then that eventually their inconsistent and conflicting decisions would render imperative their consolidation into a single agency - or that I would be the one to suggest it.

Nonbank financial institutions were still content to serve the special purposes for which they were created. No one then would have thought that they would soon be demanding the broader lending and investing powers of banks free of equivalent supervision, regulation, and taxation.

Since then, our every-day business jargon has been enlarged by such terms as Federal funds, negotiable CD's, currency swaps, Roosa bonds, the GNP gap, and structural unemployment. We have had rising competition between banks and nonbank financial institutions at home and a growing sense of competitiveness in economic relations between us and our allies in the Western world. The creeping inflation problem that seemed so formidable in the early 1950's

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has been replaced in the headlines by attention to high levels of unemployment and persistent balance of payments deficits.

These changes - and many others like them - have altered the environment in which banks and other businesses must operate, and they have also altered the environment in which the Federal Reserve has to perform its monetary and supervisory functions. They have thrust upon the Federal Reserve a repeated and unrelenting challenge - the challenge of change. And the resulting necessity for choosing when and how to respond - when to move and when to stand fast - has brought forth many gray hairs for me and all of my colleagues.

Change has been a demanding mistress in the 1950's and early 1960's. She has called for the introduction of new policy tools and for new ways of employing the traditional tools. In addition, she has demanded the consideration of new policy goals.

The striking character of the challenge is manifest if one recalls that these years were ushered in by the Treasury/Federal Reserve Accord of 1951. Monetary policy had lain dormant throughout much of the war and postwar years; like so many individuals and institutions, the Federal Reserve had been drafted into service for the duration, and it was not to receive an honorable discharge for six years following the end of the war. But after a ten year period of forced inactivity, monetary policy was at last freed to meet the challenge of the times.

I regard the 1950's as the proving years for American monetary policy, when for almost the first time the necessary understanding of its operations and the required implements were available to be marshalled full strength in combatting the vicissitudes of business cycles. The 1951 Accord marked the beginning of a highly successful decade for monetary policy, one in which its effectiveness in pursuing the twin goals of price stability and high levels of employment was fairly well established.

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In that decade those goals of sustained economic activity and the prevention of dangerous inflation and deflation were the prime targets of our monetary policy. In the early part of the decade, creeping inflation was our paramount concern. It was finally brought to a halt, thanks to some good fortune and an effective combination of private and public policies - including, in particular, the willingness to use monetary policy vigorously in spite of widespread criticism.

The philosophy which governed the use of monetary instruments during the '50's was to strive for the maximum generality of influence. Reserve needs of the economy were met with the minimum practical interference with market decisions. This philosophy was epitomized in 1953 by what came to be known as the "bills preferably" policy. In a nutshell, this policy meant that the Federal Reserve's open market operations would ordinarily be confined to the Treasury bill market, where its activities would have the least direct effect on rates. Of course, as all knowledgeable people were aware, it was always contemplated that the rule could and would be altered in the event of need therefor; for example, on occasions when the existence of disorderly markets called for intervention in other maturity areas of the market. But in ordinary circumstances, the aim was a straightforward one to achieve minimal interference with market allocations of funds.

In a speech of September 1953 I found myself asserting that one of the great virtues of monetary policy as then applied was that changes in the structure of interest rates were determined by interplay of the demands of a freely functioning market and a supply of bank reserves and money that was attuned to economic needs rather than the desire to hold down or push up particular interest rates.

Any other course risks a progressively increasing dependence of the market on official judgments as to appropriate levels of rates and allocations of funds, with a corresponding stultification of independent private judgments that are the backbone of a well-functioning competitive market.

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Considerations of lessening interference with the market also surrounded the dismantling of the bulk of the apparatus of selective credit controls during the 1950's. Regulations W and X, which prescribed minimum down payments and maximum maturities on consumer credit and real estate credit, generated some of the most explosive topics that appeared on the Federal Reserve's agenda in my early days as a Governor. Perhaps they served their rough and pragmatic purpose in moderating particular kinds of demands during an inflationary wartime period when general controls were unavailable, but I experienced profound relief when the unshackling of monetary policy made it possible to permit demands for credit to again be left to control by free market forces, and administratively imposed selective controls could go the way of ration books and gasoline stamps.

I feel much the same way about Regulation Q, setting ceiling rates on time deposits. It was my hope that the banking system would employ the recently increased interest rate ceilings in a way which would dispel doubts about the ability of banks to maintain good business sense while competing vigorously for depositors' dollars. In fact, I had hoped we would see sufficient signs of responsible bank competition in this field to justify a conversion of Regulation Q authority to a standby basis. But I regret to say that the ability of market forces to discipline the range of rates paid on such deposits, without adverse consequences to the banking system and the economy generally, has not yet been convincingly demonstrated.

As for our last remaining selective credit control - margin requirements on stock market credit - I must say that the strong fluctuations in credit usage in that area lead me to the reluctant conclusion that it will be a long time before that credit area can be regarded as sufficiently self-disciplined to justify putting controls on a standby basis.

There is one other monetary tool whose reactivation during the 1950's gave me satisfaction. This is the discount mechanism. For about twenty years preceding the Accord, the discount window was unused as a result of the plethora of reserves provided to the banking system during the

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depression, the war, and the early postwar years. Its resurgence was part and parcel of the operating philosophy of the 1950's, providing expanded leeway for market actions and market initiative to balance out financial pressures. The development of clearer standards of the appropriate purposes for which member banks could come to borrow at the discount window was, I think, a signal achievement. This re-emergence of the discount window also helped to draw closer the Reserve Banks and the Board of Governors and to strengthen their mutual understanding of each other's problems and responsibilities. As a result, the Federal Reserve System has become a closer-knit and more cohesive working body.

But the world has a way of not allowing us to rest with the resolution of older problems. Scarcely had the inflation of the early 1950's been brought to a halt when the economy began to display signs of sluggishness. Creeping inflation was succeeded by creeping unemployment, as evidenced by a higher unemployment rate at comparable points of each successive cyclical upswing. Furthermore, we had no sooner redirected monetary policy to focus on the problem of underutilized resources when still another and apparently conflicting one was thrust upon us. Our deteriorating balance of payments began to demand attention, and it was viewed as imposing an outside restraint on the free workings of domestic monetary policy, in a manner somewhat analogous to the restraint that was imposed by the fears of a collapsing government securities market during the pre-Accord days a decade earlier.

The worsening balance of payments led to the broadening of the Open Market Committee's policy directive in 1960 to include "taking into consideration current international developments". Because the needed basic remedial policies - both public and private - were not forthcoming, monetary policy and debt management policy began to function with one eye on the Treasury bill rate. For monetary policy, this orientation resulted in the absence of an aggressive policy of monetary ease that would adequately stimulate economic activity, just as the pre-Accord pegging of government security prices resulted in the lack of an aggressively tight policy adequate to combat inflation.

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The consequence may have been to delay longer than necessary both the achievement of a satisfactory domestic situation and the correction of our adverse balance of payments position.

Throughout the past two years I have been of the opinion that the interests of the United States would be served best by maintaining a broadly stimulative monetary policy. This I believe would have been appropriate in the light of both of the basic problems our economy has been facing: incomplete utilization of domestic resources and a persistent balance of payments deficit. Both problems would be mitigated by an expansion of domestic economic activity within bounds that did not result in upward pressures on prices and costs. An increase in domestic demand would certainly employ more men and machines, and probably give rise to more rapid investment and more efficient capital as well. Such an environment would also offer higher returns on capital, and eventually sustain a higher level of interest rates, thereby attracting some investment of capital and savings in this country that might otherwise seek outlets abroad.

Of course a key element in this or any other rational stabilization policy must be the maintenance of reasonable levels of domestic prices and costs. Otherwise imports would grow rapidly and our exports would lose their ability to penetrate foreign markets. However, an increase in domestic market demands, activating idle productive capacity and stimulating more productive investment, could within limits have bolstered the international competitiveness of our cost-price structure.

I hasten to say that monetary policy alone is not capable of achieving all these objectives. Other public and private policies, particularly including a well-timed stimulative fiscal policy, are also essential. But appropriate monetary policy can create a climate in which other market forces in our competitive economy will find it easier to bring about more vigorous use of domestic resources and better balanced flows of goods, services, and capital funds internationally.

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I would add, almost as a footnote, that there has also been a need to avoid excessive monetary ease; that is, credit ease so great as to spill over in an inflationary bidding up of prices and costs of goods sold, or a wave of speculative credit extension. Such eventualities, had they occurred during these two years, would have hurt both our domestic economy and our international balance of payments. But, as we all know, inflationary forces have not been noticeable during this period.

My purpose is not to rake over old coals. I recognize that the developments of the moment may not always provide the monetary authorities with the clean and clear-cut problems, and the ideal complement in terms of other public and private policies, that would permit the best possible utilization of monetary tools. Furthermore, I recognize that in any organization composed of not one but several decision-makers meeting as a Board or a Committee, judgments must often differ in a subject area as complex as this. Indeed, I think it was part of the genius of the framers of the Federal Reserve Act that they implicitly recognized the inevitability of differences in judgment, and built a pyramid of judgmental bodies, from Reserve Bank Boards of Directors to the Federal Open Market Committee and the Board of Governors, in which policies would be evolved through mutual education and the derivation of consensus. In this kind of policy-making apparatus, I think each one of us must resign himself to occasionally being part of the minority - while striving to convert the minority into a majority. This is part of the educational process. My sole purpose is to stress the importance of the hard-won principle of minimal interference with the market, which has contributed so much to the effectiveness of U. S. monetary policy. If we are sincerely convinced of the wisdom of that course, we are more likely to learn, from each occasion on which we are driven to depart from it, how to cope with exigent situations without gradually undermining the principle itself.

In conclusion, let me say that I am proud to have been associated with the Federal Reserve System for the past dozen years. I know firsthand that it possesses intelligence and integrity, that it is big enough to encompass

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and effectively utilize all points of view, and that it is manned by conscientious men and women who strive to perform their work in the public interest.

In spite of the fact that I have not agreed with all the actions that have implemented Federal Reserve policy during these years, I have sanguine hopes for its future; for more important than any particular change that took place during this period is the fact that evolution did occur. This fact demonstrates that the Federal Reserve System is a vital, adaptive institution that can accept and respond to the challenge of change.

I am confident that over the years the System will exercise its power over money and credit to avoid unsustainable economic upswings and disastrous downswings, to foster high levels of economic growth and employment - without inflation. I know it will judiciously vary the application of monetary policy from time to time in response to change, and I trust that it will strive to avoid changes for the sake of expediency or appearance or to appease those who would endeavor to utilize monetary policy for purposes for which it is not suited. I hope monetary policy will be employed in ways that harmonize well with the unique nature of the American economic system and the equally unique character of its financial institutions and markets. Our economic system is bigger, freer, more competitive and more dependent upon private initiative than any other, and we need a monetary policy to match if it is to realize its full potential for promoting the economic well-being of the American people.

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