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**Remarks of J. L. Robertson  
Member of the Board of Governors  
of the  
Federal Reserve System  
at the  
73rd Anniversary Convention  
of the  
California Bankers Association  
Coronado, California  
May 25, 1964**

## An Inside Look at the Federal Reserve System

It is a real pleasure to have an opportunity to come to California, for I always enjoy visiting here. For one thing, there are almost as many people here from my home town, Broken Bow, Nebraska, as the number still living there. The California climate obviously has great appeal for midwesterners.

Once there were two spiritualists in Broken Bow who agreed that the one who died first would come back and report to the other on how he found things in the spirit world. Charley died first, and at the agreed upon time the survivor, Joe, went into a dark room and began calling, "Charley! Charley! Can you hear me?" After some time a faint answer came back, "Yes, Joe, I hear you." Excitedly, Joe called out, "Charley, how is everything?" Again came the voice, "Joe, it is really wonderful! You wouldn't believe it! It isn't a bit like Broken Bow. It is always bright and sunny here. I don't have to do a lick of work. I just eat and sleep and play around all day with cute bunnies." Flabbergasted, Joe said, "Charley, do you mean to tell me that the angels in heaven play around that way?" The voice came back, "Who said anything about heaven? I'm a jack rabbit in California."

It would be very nice if all of us had come here just to sleep and eat and enjoy the lovely scenery, but I know that I am expected to make a few serious remarks and you are expected to listen to them. I hope that this will not greatly mar the pleasure of the occasion for either of us. I should like to discuss a subject which is of the utmost importance to you, first as citizens of this great land of ours, and second as bankers.

For the past three months a Congressional Subcommittee has been investigating the Federal Reserve System and its conduct of this nation's monetary policy. Now any institution as important as the Federal Reserve needs to be scrutinized closely. Its influence on the economy is too great to allow it to rest on past accomplishments. The public has a right to know whether its central bank is serving the public interest and is keeping abreast of changing times in so doing.

The purpose of the current investigation is to gather information to serve as a basis for action upon a number of bills which have been introduced in Congress. Some of these proposals are of minor importance, but others, if enacted, would fundamentally change the structure of the Federal Reserve System.

The bills would expand the present seven man Board of Governors to a twelve man Board. The Secretary of the Treasury, who was removed from the Board in the overhaul of the Federal Reserve Act in 1935, would return to the Board as its Chairman. The System would be obliged to obtain annual appropriations from Congress to meet its expenses. The Comptroller General would be authorized to audit the System. The Federal Open Market Committee, which is composed of the seven members of the Federal Reserve Board and five of the presidents of the Federal Reserve Banks would be abolished, and all of its powers would be transferred to the enlarged Board of Governors. The bill that would require us to support government bond prices when market yields equal or exceed  $4\frac{1}{2}$  per cent really represents an effort to carry out one aspect of monetary policy by inflexible legislation. Less far reaching proposals include the retirement of member bank stockholdings in the Federal Reserve Banks and an increase in the Federal Advisory Council from twelve members to an unwieldy fifty-two.

These bills, which ostensibly are designed to change the structure of the monetary mechanism, should not be opposed simply for the sake of maintaining the status quo, nor should they be adopted simply for the sake of change.

In extensive hearings, testimony has been received by the Subcommittee from every member of the Board of Governors, every president of a Federal Reserve Bank, the Secretary of the Treasury, many academic economists, and representatives of financial groups and institutions. As might be expected, this testimony has disclosed a wide variety of views, not only as to the proposed structural changes, but also as to recent monetary policy - some believing it has been too easy, others too tight, and still others about right.

I must say that it is not obvious from reading the testimony that even all of these "expert witnesses" have ever had an inside view of the Federal Reserve System. This is not to cast aspersions on them, for the fault probably lies within the System itself. But certainly it is essential to a fair weighing of these proposals, and any others that may be introduced, that people understand exactly what is at stake. First of all, they must know what the Federal Reserve System is and what are the ingredients of an effective performance of its functions. So let me say just a few words about it.

The Federal Reserve serves the nation by performing many supervisory functions and financial services for the banking system and the United States Government, but its most significant contribution to the economic welfare of the people of the country is through its activities as the national central bank. In this role, it is the creator of bank reserves, the lender of last resort, and the regulator of the money and credit supply - functions that profoundly affect the value of every one of the dollars in our pockets, few though they may be. As keeper of the gate, it tries its best to see that the money and credit supply is kept in proper relationship to the volume of goods and services available for purchase, and thereby to moderate business ups and downs - booms and busts.

Frankly, this is a pretty complex business - one with few easy answers, and sometimes with no final answers at all. It is run by human beings, and that means it is always subject to their human failings. Furthermore, the best laid plans can be upset by uncontrollable factors such as public psychology and abrupt changes in the spending and savings habits of people. All we can do is to keep abreast of economic developments and try to devise policies which are conducive to a stable, prosperous, and growing economy.

In formulating over-all monetary policy, the Board of Governors, as you may or may not know, meets every day, and it meets with the Reserve Bank presidents once every

three weeks as the Federal Open Market Committee. Incidentally, in the Open Market meetings only five of the presidents have a vote, but all twelve participate, and I might add that the quality of each president's contribution is in no sense related to his power or lack of power to vote.

Our meetings are informal. We do not wear robes and we do not use Robert's Rules of Order. Still the meetings are orderly and each participant can usually state his views without interruption. As a matter of fact, since no part of our work is delegated, each is expected to state his views on every item on the agenda. Although one presses vigorously for his position at the meetings, outside the room we generally present a united front.

In making policy judgments, the Board members and Reserve Bank presidents have not only their own abilities and experience to lean on, but also the members of what I regard as one of the finest advisory staffs in the world: lawyers, bank examiners, operations and market specialists, and - most of all - economists. The Federal Reserve Board and Banks, all told, employ more than 350 professionally-trained economic research men and women - with a sum total of advanced degrees and years of research experience that would be the envy of any university faculty. I know you have heard the old saw that a large number of economists could be laid end to end without ever reaching a conclusion, and you may be wondering how far our stable of 350 would reach. Well, I must say I do not know, because our economists do not lie down; they stand up and tell us what they think the facts are and what they mean. In our establishment, freedom of thought and expression is not only encouraged but expected.

Our staff collects and analyzes for us a massive flow of economic intelligence, including developments in every major phase of business activity, both domestic and international. They give us hour-to-hour reports on financial markets, day-to-day and week-to-week analyses of banking changes, and about every three weeks a full run

down on the current state of all sectors of the economy. They are constantly analyzing economic data, developing new insights into financial problems, and testing old and evolving new theories as to financial and economic processes - all to the end of giving the System the best possible objective foundation on which to base its policies. We long ago came to recognize that intelligence and judgment are of very little value in this field without a solid foundation of fact, just as any amount of factual data is of little value unless it is wisely interpreted and applied.

This flow of information and analysis to the Governors and Reserve Bank presidents places in the hands of each the raw material he needs to formulate an intelligent and impartial policy judgment. But such judgments, once they are formulated, must be applied with utter integrity. There is no room in the Federal Reserve for partisan sponsorship of the interests of particular groups. Each one of us is under oath to make monetary policy decisions which are designed to serve the best interests of the nation as a whole, whose will is concretely expressed in legislation calling for maximum employment, price stability, and economic progress. I cannot imagine any of my colleagues intentionally placing the interests of a particular institution or group ahead of the public welfare.

Effective monetary policy is difficult to formulate under the best of circumstances, and is almost never popular. We always seem to be stepping on somebody's toes. Invariably there are voices of protest - those who would have us expand the money supply faster in the hope that this will solve specific problems such as unemployment, and those who would have us restrict the supply to fend off inflation, to solve a balance of payments problem, or, seemingly, just to raise interest rates. But effective use of monetary policy depends on a body with sufficient impartiality, intelligence, and integrity to hold to whatever policy it believes is called for by existing economic facts. It must be willing to follow a stimulative policy when the economy needs it, and yet be willing to

quickly switch policy if and when, for example, an inflationary situation arises. It must not be so afraid of criticism that it begins to fight inflation before inflation exists, thus risking an economic downswing, or so fearful of making a mistake that it holds to a given policy long after the need for it has expired. Of course, mistakes will be made - humans are not infallible - and that is why we approach our work with great humility.

The point of all this is simply that those who really understand and appreciate the importance to the national economy of sound monetary policies will want to weigh all relevant legislative proposals in the light of whether they will result in a stronger, more effective central bank or a weaker one that will vacillate with every political wind or special interest pressure. An evaluation of this kind is essential if we are to avoid erosion of the System's independence - not independence as an end in itself but as a prerequisite for effective application of the other three "i's" I have mentioned: impartiality, intelligence, and integrity.

Seen in this light, central bank "independence" is not an absolute doctrine. The Federal Reserve cannot be independent of the government in the sense of charting its own course of action without regard to other governmental policies. On the other hand, it should not be subservient to the dictates of any minority group within the executive or legislative branches of the government. If it is to achieve its assigned objectives, its responsibility must be directly to the framer of those objectives, namely, to the whole Congress, whose agent it is.

Given these basic tenets, the Federal Reserve should be free to formulate and implement its decisions to increase or decrease the cost and availability of money and credit on the basis of its own impartial assessment of economic and financial conditions - not on the basis of hopes or wishes, pressures or politics.

Albert Gallatin, Jefferson's Secretary of the Treasury, once said:

"Independent of every temporary party consideration, there are questions of right and wrong, of what is just or unjust, which must be settled on that principle alone. Such is the question of currency."

A century later, this philosophy was shared by President Woodrow Wilson and Senators Carter Glass and Robert L. Owen, who fathered the Federal Reserve System. They designed this unique structure, endowing it with a high degree of independence, with the hope that the management of the currency of the United States would, in so far as is humanly possible, be insulated from temporary political considerations and settled on the principle of what is right and wrong, what is just and unjust. Carter Glass expressed this hope in these words:

"While the Federal Reserve Board may never... become so detached and so completely independent of legislative and executive influence as to assume the status of the Supreme Court of banking, as many eminent bankers have desired, it is certainly to be devoutly wished that it may permanently hold such a high place of appreciation in the confidence and esteem of the country as to make it futile, if not positively dangerous, for political vandals to practise their arts against it. An intelligent and fearless performance of its functions involves as much of sanctity and of consequence to the American people as a like discharge of duty by the Supreme Court of the United States."

It was no accident that the Federal Reserve Board was relieved of dependence upon annual Congressional appropriations to meet its expenses, just as it was no accident that the terms of its members were made unusually long - fourteen years. It was recognized then, as it must be now, that without such protective features its independence might become a hollow sham.

Let it be remembered that monetary management during the fifty years the Federal Reserve System has been

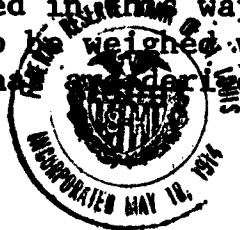


in existence has never been tainted with the breath of scandal. No charge that the System's actions were motivated for partisan political ends has ever been made, for it could never have been sustained. The judgment of the Board has frequently been criticized, as is to be expected in an area where strong differences of opinion are usually abundant, but no one has ever been able to say that the judgment of the Board or of the Open Market Committee was deficient because these bodies - or the staffs that served them - had been loaded with low caliber men who owed their positions to nepotism, cronyism, or politics.

Quite the contrary. The System enjoys an enviable reputation for the quality of the personnel that serve it, present company excepted. Its ability to attract and retain men of high caliber derives in no small measure from its independence from political and special interest pressures. It is able to offer an opportunity to do an honest professional job in behalf of the general public, with a high degree of career security, and in return it is able to demand a high degree of professional competence.

There can be no question of the advantages to the nation of maintaining the independence of the monetary authority. The only question may be whether the price is too high. The proposal to force the System to submit to the discipline of obtaining an annual appropriation from Congress to meet expenses might suggest that the present mode of operation results in excessive expenditures.

Of course, it would be possible to effect economies by radically altering the basic structure of the System. The maintenance of twelve independent Federal Reserve Banks, each with its own Board of Directors and official staff, is no doubt more expensive than would be the maintenance of a single bank with the requisite number of branches. However, there has been no suggestion that the System be reorganized in this way, and if there were, the matter would have to be weighed with full consideration of the advantages that are derived from the existing structure.



In my judgment, the proposal to make the System dependent upon annual Congressional appropriations cannot be justified by the hope of effecting great economies, and I have not yet heard anyone so contend. If the cost of making this fundamental change is not to be measured in money, then it must be measured in terms of the potential damage that might be done to the nation's economy by diminishing the independence of the Federal Reserve System - independence espoused by Woodrow Wilson and honored by every President in the succeeding half-century.

In this country and abroad, it has been demonstrated again and again that central bank independence from the Treasury and from political influences can be important in the maintenance of sound monetary policies. We witnessed this here during the years immediately following World War II. There was conflict at that time as to whether monetary policy should be used to combat inflationary pressures or whether this battle was to be lost for the sake of minimizing the cost to the Treasury of servicing the federal debt. That dispute was fortunately settled in 1951 by the Treasury-Federal Reserve Accord. Since then great reliance - some think too great - has been placed on monetary policy to avoid economic instability and to help shape the economy to best meet the needs of our people.

It is important for other reasons that the United States maintain an independent nonpolitical central banking system. Traveling in other countries, I have been impressed by the degree to which adherence to sound monetary policies has been hindered by inability of the central bank to resist political pressure. I have seen country after country where the monetary experts have wanted to combat the inflation that was ravaging their country's economy. They have known what had to be done, but they have been powerless to act because they lacked the necessary independence and stature which the Federal Reserve System has wisely been accorded. However, I suspect the example of the Federal Reserve has saved many of these central banks from being rendered even more subservient to the short run interests of their governments. I fear

that if we should retreat from our high standard in this respect, the results might - in the long run - not only adversely affect our domestic policies but set the stage for a weakening of central banking institutions and a further weakening of monetary discipline in many of the less developed countries of the world.

This would be of direct concern to the United States. We are spending annually large sums of money to encourage the growth and development of these economies, but the sad fact is that the expenditure of these funds has not achieved the desired results, in large part because these countries have failed to control inflation and to create conditions conducive to sound economic development. The world badly needs more strong and independent central banks which can defend monetary integrity against both political expediency and special interest pressures.

My purpose in dwelling at some length on a single aspect of just one of the proposals is not to indicate either approval or disapproval of any of the pending bills, but merely to emphasize the importance of weighing each of them in the light of their possible impact on the independence of the System. Structural changes in the Federal Reserve may be needed, although in my view, whatever structural shortcomings some may claim to see in its organization chart, the System is a flexible and effective institution; one which is particularly well adapted to the American political and economic scene. However, conscientious study may very well reveal ways of improving the System - by devising a better structure, or by finding wiser men to conduct its affairs - and all of us should give our wholehearted support to such efforts.

As it begins its second half-century, the Federal Reserve faces renewed challenges to justify its organization, its responsibilities, and its policies. This is as it should be. An organization entrusted with signal responsibilities in an area of vital and complex problems, endowed with powers to help resolve these problems,

and willing and able to pursue its objectives aggressively, will, in a democratic society, be subject to criticism, concern, and controversy. A viable institution will thrive on this criticism, will accept the constructive and reject the ill-advised, always being aware that, ultimately, it is for the people - acting through their legislative representatives - to approve or disapprove the conduct of its affairs and to restructure it whenever that seems desirable.