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Remarks of J. L. Robertson, Member of the
Board of Governors of the Federal Reserve System
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"In Defense of Monetary Policy"

Nothing could be more inappropriate, I suppose, than to make a defensive - a negative - speech in this city, which is regarded throughout the world as one of the two temples dedicated to the twentieth century cult of Salesmanship with a big "S". In defiance of all sound and accepted principles of successful selling, I want to go on the defensive with you about the justification for the existence of such a thing as American monetary policy.

On many of the occasions when it has fallen to my lot to explain or defend American monetary policy and the decisions and actions of the Federal Reserve System, I have envied the people who sell the product for which Detroit is world famous. Of course the grass in the other man's yard is always greener, but it seems to me that it must be inspiring and relatively easy to get your audience - and yourself - stirred up about two solid tons of power and convenience and comfort, wrapped up in chrome and upholstered in nylon. It is a little more difficult in dealing with a subject that has not a single appealing "human interest" attribute - it is abstract, complex, and vague, and by no stretch of the imagination can it be said to open up a path to wealth, beauty, prestige, or even a good night's sleep.

In the crudest terms, monetary and credit policy is simply an effort to answer the question: How much money should our country have? In this use, of course, "money" means bank deposits; at least, that is the bulk of it. One of the clean-cut achievements of the Federal Reserve Act is a currency system that is practically automatic and foolproof; currency in circulation goes up and down exactly in response to the needs and demands of business and the public. But the "money" that has the greatest impact on the American economy - the economic welfare of the American people - is check money, deposit money.

There have been periods in our lifetime when the economy experienced unnecessarily severe setbacks for lack of money, and other times when many people were injured because there was a plethora with the inevitable result of more money being spent without a corresponding expansion of goods and services - that old devil inflation.

If I were in your place, I might be skeptical about a Washington-centered operation that purports to know how much money the United States needs and how that need should be supplied. When we observe the clumsiness and the fumbling that seem to be associated with much of governmental activity (although there are some of us who think this fumbling is more conspicuous in government than in business only because government operates in a fish bowl), we are tempted to believe there is a great deal of truth in Emerson's dictum that "the less government we have, the better."

However, it is about two centuries too late for serious discussion of the ultimate utilitarian worth of the industrial revolution - and its fuel, modern finance. Whether for good or ill, the industrial pace of the world becomes faster and faster, and any suggestion that it will go on better if left to itself is a little like suggesting that we start a nuclear chain reaction and then leave that alone.

Perhaps the notion that the least government is the best government was valid in the age of Thomas Jefferson. But the truth and wisdom of one century may be error and folly in another. As mankind uses new forces, whether mechanical or economic, it must control and direct those forces. In 1800, or even when I was a youngster in Broken Bow, Nebraska, during the early part of this century, a good horse could be counted on to carry its rider or to draw its carriage back home with little or no guidance. Today, even with power steering and automatic transmission, our automobiles cannot do that - they have to be guided. In the same way, when money consisted of gold and silver it needed very little regulation, although by the same token it often did a pretty poor job in times of crisis. Now we have a money system with enormous flexibility both to expand and to contract upon demand, but like a jet plane or an atomic pile, it calls for attentive and intelligent management. "Money will not manage itself," as a great British economist said almost a century ago.

Come to think of it, perhaps it is you and not I who should be on the defensive about monetary policy. The whole thing started when some goldsmith, unusually alert and courageous, began to lend other people's money. He had learned from experience that the people who deposited their gold in his strong box never did call for their hoards simultaneously, and consequently that he could safely lend some of it to others, for his own additional profit. He never knew it, but at that moment he was planting the seed of the modern institution of monetary policy and of such twentieth century phenomena as the Federal Reserve System.

The System has almost never lacked for articulate critics - certainly not during the past year. As to the soundness of current Federal Reserve policy I prefer to let the record speak for itself. But even when the record has turned out fairly well, some complaints seem to persist. In large measure, I believe, this is due to an incomplete understanding of central banking. While most of this criticism seems to be directed primarily at us, I suspect that when you discourage and even reject some of your loan applications - as I gather you must have been doing recently - some of it, unfortunately, rubs off on you, for we are inexorably bound up in a partnership.

The allusion to a partnership is not casual rhetoric. The commercial banks of this country, which you represent, and the Federal Reserve

System, with which I am associated, are partners of a sort in the operation of the monetary system of the United States. Between us we control the creation and supply of the nation's money. Other institutions - mutual savings, building and loan, insurance, and finance companies - extend a lot of credit, but they cannot thereby create new money. They can expand the volume of private debt but not the money supply with which such debts must ultimately be paid.

A partnership plagued by misunderstanding is a weak one, but one based on profound trust and complete understanding can provide a foundation for constructive action. Furthermore, what each of us does is of considerable importance to the other. For example, the quantity of reserves we make available has an important bearing on your credit-granting facilities. Sometimes you probably think us a bit niggardly. We may seem to get in the way of accommodating the customers you like and value. And still other times you may feel that the reserves we more willingly make available tend to drive interest rates down more than you really like. On the other side, I shall not deny that at times you give us concern by the way in which you manage your affairs. And so we must be very careful to keep our line of communication open and working - in both directions - and thus to avoid misunderstandings.

Let me launch the exchange with a few words, from my end of the line, about twentieth century monetary policy. It is sometimes described as an art, but in my view it is actually the most difficult and most significant form of applied economic science - not science in the mathematical and test-tube sense, but the discipline of reaching generally valid conclusions on the basis of a great mass of information of varying reliability.

Like most conscientious artisans, we attempt to bring scientific methods to bear on our problem. The System has built up a highly competent and comprehensive economic intelligence service both at the Board of Governors and at the Reserve Banks. This service not only sifts, analyzes, and interprets the standard published sources of economic information, but is itself a major compiler of new data. That is why our staff people so often bother your comptrollers with requests for new and special-purpose data.

In the end, more than data is needed. The state of economic science has not yet advanced to the point of giving definitive answers; it can only yield evidence. And to this extremely valuable evidence we - the policy-making heads - must add another factor: human judgment. And judgment is fallible; that I am sure you will grant, and - having granted it - will be merciful when we make our next mistake.

But information and judgment alone are not a sufficient basis for successful monetary policy. At least two other ingredients - even rarer

ingredients - are called for. One is a combination of integrity and detachment, and the second is courage to carry out the decisions dictated by careful judgment.

The amount of money and credit we supply to the economy is of vital importance. Perhaps that is a cliché, but it is very true. Too little money and credit can inhibit economic growth and even normal economic functioning; it can prevent full utilization of our resources. But too much money and credit have the unhealthy effect of stimulating an unsustainable boom. Some place in the middle there is an amount that is just about "right". Ascertaining this right amount is a difficult job and an agonizing responsibility.

The difficulty arises because we do not have exact or mechanical guides - formulas that apply at all times. For generations, economists have been relating the amount of money and credit to a great many different economic measures, such as income, the volume of trade, and the amount of national product. Over long periods of time these relationships show a certain amount of consistency. But during some periods they vary considerably from their long-term averages. And quantitative monetary policy must be addressed to the existing state of business activity, not to long-term averages.

During the past year the amount of money - that is, demand deposits and currency - has grown less rapidly than national income or national product. The credit-restraining policies of the Federal Reserve doubtless were chiefly responsible for this. If monetary policy had been focused on a mechanistic formula or relationship, greater credit ease would have been called for. But the proof of the pudding is in the eating and not in the recipe. In the jargon of economists, aggregate demand in 1956 has pressed hard against aggregate supply. More money would not have helped bring more goods into existence; it would only have made the goods actually produced cost more. The answer given us by a monetary Univac probably would have led us astray.

One of the perplexities we face in trying to determine the "right" volume of money for our economy is due to the fact that business developments are almost never of a uniform nature. Some parts of the country and some industries may be operating at very high levels while others are in the doldrums. Consequently, some people urge, with plausible logic, that monetary and credit policy should be of a selective sort - to be aimed at curbing the economic activities that exceed sustainable rates of growth without penalizing others that are less active. However, I am sure you are aware of the difficulties of doing this - of achieving the almost omniscient wisdom required for the management of such a system. We would need many supermen, but we do not have even one.

One of the reasons for such unequal business developments is that we live in a dynamic economy. New industries are constantly arising and

driving a wedge into the market. The business they secure often is at the expense of established industries. In other words, because we have a dynamic and deeply competitive system, each industry, as well as each person and company, must fight to keep its place, and the fights seldom end in a draw. General prosperity does not insure the prosperity of every industry or every area. Monetary policy does not and never should undertake to gear money to the business needs of a single industry, even of a very great one.

Recent history provides a particularly apt illustration of unequal rates of development. All of us know the story of agriculture during the past few years. You most certainly have struggled with the fact that automotive sales in 1956 did not equal the remarkable level reached in 1955. And housing starts have recently lagged a bit. But, on the other side of the picture, there has been a very high level of construction generally. A drive through any of our great cities and its suburbs is a striking demonstration of this fact. As a result, we have faced near-shortages of some materials. Almost every employable worker has a job. Some prices have declined but many others have advanced; the net pressure has been upward. The problem is one of balance. The job of central banking consists in part of adding up plus and minus "X's" and "Y's" when we do not know their exact values but still must arrive at the right answer!

Such great variations in regional and industrial experience doubtless account for some of the criticism of the System. And that is understandable, for it is a considerable feat of selflessness for the representative of a region or of an industry to look beyond his own problems and to see them in the perspective of the general welfare. But that is the exact role the Federal Reserve System must play - to serve the interests of the whole economy, not just a part of it.

Ultimately, the economic evidence, however conflicting, must be reduced to a form that provides a foundation for action. When action is called for, we must decide what kind of action to take. As you know, Federal Reserve credit action can take any one, or a combination of three general forms; we can change, within limits, the legal reserve requirements for member banks; we can take the initiative in changing the volume of available reserves through open market operations - that is, the buying and selling of government securities in the open market; and we can change the price you must pay for the reserves you borrow from your Reserve Bank.

Our power to change reserve requirements has been used rather infrequently during recent years. It is a sweeping sort of power; too blunt for regular use, but still the basic weapon in our arsenal. Open market operations are the means most frequently used by the Reserve System to supply or withdraw reserves and thus to keep the volume of reserves appropriate to prevailing circumstances. But such operations affect the

banking system as a whole and, as you know better than I, individual banks often have special problems of reserve adjustment. Here is where discount operations enter the picture. Let me say just a word about them, with the view of "clearing the line"

The discount facilities of the Federal Reserve System were provided and exist today to give member banks a little time in which to adjust to the exigencies of the moment - a kind of safety valve or emergency fuel tank. The most significant feature of the rediscount facility is your use of it, the way in which banks play a part in developing and executing the policy aspects of monetary action. You have been assured before, and I can assure you again, that the discount windows of the Federal Reserve System are always open. But this assurance is a two-sided matter: it depends on our belief that as prudent bankers you will use and not abuse the facility. Those of you who have studied the revised form of Regulation A will appreciate what I mean. Much thought and care were put into that Regulation; it expressed, I believe, a standard by which you can guide your resort to borrowing.

The discount facility was designed to enable banks to meet temporary and unforeseen needs, not to supplant basic liquidity planning. In using the discount privilege in order to meet customer demands, you bankers have a real responsibility - on a par with that of the Federal Reserve - to utilize this safety valve in a way which will redound to the public good, not just private profit. For all of us know that when a boom has reached the point of using almost all of the employable economic resources, further credit cannot increase the available goods and services; it can only push up their prices.

Also, because it has been the basis of misunderstanding in the past, perhaps the "line" should be "cleared" with respect to our process of policy formation. The determination of whether action should be taken, and, if so, which instrument to use, and when, and how much, must be conducted with secrecy. It would be manifestly unfair for us to tip our hand to privileged persons. Consequently, we have acquired a reputation for being unduly close-mouthed. That reputation may be justified in some respects, but we sincerely wish to be as candid as the situation permits, and to foster universal understanding of the principles by which we operate. This sort of understanding can be achieved through plain speaking, and a real conviction that occasional bruises to personal feelings are a small price to pay for the freedom to criticize and the goad of criticism.

But perhaps the largest area for misunderstanding and criticism lies around the determination of a "satisfactory" level of economic activity; the course that will keep us in the safe but narrow channel, away from the rocks of inflation on one side and of deflation on the other. One thing of which we can be almost certain is that inflation, at least in small doses, appeals powerfully to many persons. Despite the lip service that most of us pay to the glories of the stable dollar and the

year-after-year plateau in the cost-of-living level, most Americans that I know get a glow of satisfaction from steady increases in their dollar income. Commodity price indexes may come and go, but anybody knows that \$10,000 a year is a lot more money than \$7,000!

I need not tell you that the Federal Reserve System cannot increase or diminish the supply of money and credit merely by pushing or pulling a throttle, any more than we can control public psychology, spending habits, savings habits, or special pressures from agricultural, industrial and labor groups that result in price and wage increases and governmental subsidies of one sort or another. But it is undeniable that our influence over the economy is a major one.

In exercising this influence, we would receive relatively little criticism - except from a few economic eggheads writing for other eggheads - if we leaned consistently on the side of what is euphemistically called an "ample" supply of money. It would certainly help to keep the economy moving at breakneck speed - for a time; it would certainly put more money in the pockets of more people - also for a time; and when the country reaped the inevitable whirlwind of such a policy, it is very likely that the justified accusations against the "money managers" would scarcely be heard in the terrific clamor. To put it briefly, an easy, open-handed policy makes everybody "richer" - provided you do not care how little your dollars will buy - and makes the wheels of industry spin like mad; and nobody really dislikes that sort of situation - as long as it lasts.

On the other hand, when a policy of restraint seems appropriate to us, we know quite well that it will be met with anguished shrieks and fulminations from some groups that find immediate increases in profits or wages somewhat inhibited by our action.

From all this you can infer that we have a difficult time hewing to the line of duty and restraint, and in disregarding the siren voices that tempt us to make the popular decision, especially when those voices are supported by a chorus of people in high positions, political and economic, whose intelligence and judgment we respect. How much more difficult - one could almost say impossible - it would be to keep to the strait and narrow path of economic virtue, and to disregard the primrose-bordered bypaths, if monetary policy were made a function of a political administration, no matter how devoted to the ultimate welfare of the American people!

Consequently, I cannot resist calling your attention to the fact that in the course of the recent political campaign the candidates were in agreement on at least one principle concerning which there never should be any misunderstanding - the "independence" of the Federal Reserve System.

One does not often hear a suggestion, from responsible sources, that the Reserve System be subjected to the control of whichever political

administration is in power at the moment. But the occasional re-emergence of such ideas, like the fascinating and somewhat checkered history of American banking itself, should remind us that, in the long run, the most effective bulwark against misuse of the great power of a central bank must lie, not in subjecting it to political control, but in bringing about a widespread understanding of: (1) what the Reserve System is; (2) how it functions; and (3) how what it does affects the individual welfare of every American. Such an understanding is vital to the continued effective performance of its work.

With that in mind, let me close with a plea and a pledge: A plea for your help toward increased public understanding of monetary policy, and a pledge that we in the Federal Reserve System will intensify our efforts to understand banking's problems and to aid in the achievement of its public aims - both to the end that monetary policy shall make an ever more effective contribution to the well-being of the American people.