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Remarks of J. L. Robertson

Member of the Board of Governors  
of the  
Federal Reserve System

Before the National and State  
Bank Divisions  
of the  
American Bankers Association

Mayflower Hotel - Washington, D. C.

December 10, 1962

## United States Policies and Latin American Progress

Several months ago I suggested the need for a fundamental reformation of our crazy-quilt pattern of federal bank supervision, a pattern which is obsolete and defies logical justification. I suggested that instead of clinging to a system in which three different federal agencies examine and regulate the commercial banks of this country, we should consolidate them into a single independent agency - a Federal Banking Commission. It would be headed by a board of five men, appointed by the President, with the advice and consent of the Senate, on a staggered-term basis. They should be specialists who know the business of banking well, men of integrity, impartiality and competence, constituting an agency that would be completely nonpartisan, even as the Federal Reserve Board and the federal courts are today. To this Commission would be transferred all the powers and functions now vested in the Comptroller of the Currency and the Federal Deposit Insurance Corporation, as well as the bank supervisory powers exercised by the Federal Reserve.

This would have a number of important advantages. It would raise standards. It would end a race of laxity among existing agencies, which too often reduces supervisory standards to the lowest common denominator. It would satisfy the imperative need for coordination, efficiency and uniformity of federal bank supervisory policies. It would eliminate the confusion caused by conflicting and inconsistent decisions (for example, on mergers). It would reduce costs and increase efficiency. Last, but not least, it would provide the banking industry with a single set of "rules of the game", ground rules that would apply to all banks alike - fairly, equitably, and impartially - and without which many institutions are finding it increasingly difficult to plan their own future activities.

Shortly after my last speech on this subject, before the convention of the National Association of Supervisors of State Banks at Bretton Woods, New Hampshire, I removed myself physically as well as mentally from the field of battle. I spent most of the ~~middle~~ <sup>middle</sup> of October in Latin America, where I engaged in some ~~on-the-spot~~ <sup>on-the-spot</sup> research into the banking and economic problems ~~that~~ <sup>that</sup> confront our neighbors to the



south. On my return, I fully expected to again take up the gauntlet, but to my surprise and pleasure, I found that in my absence, and perhaps because of it, there had developed an increasingly widespread understanding of the proposal for a Federal Banking Commission, a growing realization that it would not in any way weaken the dual banking system, and a ground swell in favor of it.

I have no illusion that the issue has been decided and that the battle has been won. However, the case for reform has been stated, not only in my earlier speeches on the subject, but in articles and editorials in widely read magazines and newspapers. There is little that I can add of an expository nature. Even if I had the power, I would not want to try to win support for the reform by emotional oratory. I can only say that the more the question has been debated, the more convinced I have become that the proposal is sound and feasible. I hope and trust that after careful, open-minded study of the pros and cons, bankers, supervisors, government officials and legislators will reach a similar conclusion. If this should be the case, the plan could be effectuated either by the President under the Reorganization Act or by the Congress through the legislative process.

Believing that I have done about as much as a man in my position can be expected to do in bringing about the needed reform, I feel free tonight to turn to a discussion of the need for reform in our thinking about the problems of Latin America. I do not pretend to know as much about this as I do about bank supervision, since - when it comes to Latin America - I am, at best, what might be called a "one-month expert". I make no pretense of being anything else, and perhaps I should hold my tongue. However, the gravity of the situation has so impressed me that I feel impelled to share my thoughts with you, in spite of the fact that they are the product of a too brief, even though intensive, survey.

I was in Mexico City when the Cuban crisis occurred. It seemed that the hand of fate itself was adding emphasis to the feeling that Latin America will influence our destiny much more in the future than it ever has in the past; a feeling that had led me to seek firsthand knowledge of the area. In those final days of October we gained a keener appreciation

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That we are still a very long way from accomplishing this was impressed upon me strongly in the first country I visited - Venezuela. Here is a country that is obviously experiencing real difficulties. The first day I was in Caracas the newspaper headlines blazoned the news of the temporary seizure of a village just a few miles from Caracas, and the slaughter of its police force, by a band of communists. The week after I left, the Tamanaco Hotel where I had stayed was bombed and badly damaged. More recently, bombings have wreaked heavy destruction on Venezuela's oil and pipeline facilities. The government has been forced to declare martial law and suspend civil liberties.

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A very important step in the treatment of any ailment is proper diagnosis, and the gnawing worry that has been troubling me since my return from Latin America is that perhaps we have failed to properly diagnose that area's ills. It appears that we have tended to see the illness largely as one of capital malnutrition and income maldistribution. The accepted remedies have been the infusion of large amounts of capital and some rush operations to reform the distribution of income through taxation and through a draconian change in the ownership of agricultural land. It appears to me that we may be mistaking the symptoms for the disease, which is really more deep-seated. If this is true, our prescribed remedies will be ineffective, and they may in some cases be harmful.

The shortage of capital in Latin America is very real and very obvious. One sign of this is the high rates of interest that prevail throughout the area. As a general rule, banks are pressing against the legal ceilings on interest rates, and they are usually finding ways of circumventing them. Bank lending rates are generally limited to a maximum of around 12 per cent a year, but commissions and other hidden charges often push the actual cost up to as much as 18 per cent. In Brazil, businessmen complain that bank officials frequently ask for a participation in the enterprise as a condition for granting credit. Even so, the banks are unable to meet the heavy demand for loans because of the inadequacy of their resources.

What's more, the banks in most Latin American countries have found that they can get around the interest rate limitations on both deposits and loans by setting up "financieras". These are finance companies which may sell shares

or accept savings deposits, issue bonds or borrow funds, and relend at rates of interest much higher than the banks are permitted to charge. For example, in Brazil where the legal ceiling for bank loans is 12 per cent, the financieras lend against good commercial paper at rates up to 40 per cent a year. In Argentina, the banks are limited to 15 per cent, but their financieras also charge up to 40 per cent. They pay 18 per cent on their shares or borrowings. In Mexico, where inflation and devaluation have been less of a problem, the financieras charge 15 to 22 per cent a year. Their bonds, which they redeem at par on sight, yield 8 per cent a year.

The high cost of money in these countries seems to have little to do with the policies currently pursued by the central banking authorities. Some of the central banks are ostensibly employing very restrictive policies; others are exercising virtually no control over credit. However, the only country I visited where money was not extremely expensive and where banks could fully meet the loan demand was Panama, where there is no central bank. I do not want to imply that central banks are useless institutions which might be better abolished. However, it is significant that Panama, which uses the United States dollar for its currency and therefore has the hardest money in the area, is the one country that has what we would consider to be a relatively reasonable structure of interest rates.

This provides a most revealing clue to the cause of the capital shortage elsewhere in Latin America. Inflation, past and present, is certainly a major factor. Some of the Latin American countries are taking painful measures to curb inflation - but once confidence in a currency has been severely shaken, it is not easy to restore it. It takes confidence to encourage savings, and to get capital to flow into a country and to stay there. Those interest rates of up to 40 per cent in Argentina may appear very attractive to lenders at first glance, but when one finds that the value of the Argentine peso has been nearly halved since last March, interest soon wanes. This is one reason why banks and savings and loan associations in the United States are able to attract money, with their 4 per cent and 4½ per cent rates,

from countries where the local institutions may be offering rates three or more times as high.

There are other explanations for this phenomenon in addition to inflation. Fears of the confiscation of property and of legislation which makes the profitable employment of capital difficult or impossible are also important in driving capital out of Latin America. Mexico has recently enacted compulsory profit-sharing legislation, which has raised a lot of eyebrows abroad. Brazil has recently enacted a law which limits the remittance of profits on foreign investments to 10 per cent a year, calculated on the basis of the registered investment. It will not permit retained earnings in excess of this 10 per cent limitation to be added to the capital base which will be used to compute future remittances. Add this to the recent nationalization there of some American-owned utilities, and you can understand why foreign investors are not exactly rushing to Brazil today.

Much concern has been vocalized over the fact that Latin Americans have been sending their money abroad and because foreign, especially United States, investment in Latin America has markedly dwindled. (In the first half of 1962, there was actually a net reflow of United States direct investment capital from Latin America.) I suggest that the remedy for this does not lie in the substitution of government-provided capital for private capital. It does not lie in attempts to locate and forcibly repatriate Latin American capital deposited in American or Swiss banks. It does not lie in exhortation or special tax measures designed to persuade Americans to step up their investments in less-developed countries.

The primary remedy, and perhaps the only workable one, lies in an attack on those factors that drive capital out of Latin America and discourage domestic savings. This means attacking some fairly prevalent ideas, one of the more important being the idea that inflation is unavoidable, or even desirable, in a developing country. This is not a new thought, but I wish to emphasize it because somehow our Latin American friends have gotten the impression that the Alliance for Progress program is keyed much more to such things as land reform

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This leads to our second questionable diagnosis of Latin America's ills, namely, maldistribution of income. Much has been said about the problem created by the great contrast between wealth and poverty in Latin America. I do not know why Latin America is singled out in this respect. The contrast there is perhaps less than in many parts of Asia. In fact, I understand that a Latin American soccer team that recently visited Russia was shocked to find that the gap between the living conditions of the rich and the poor was far greater there than at home.

I might note that thirty or forty years ago, not to mention the present, the contrasts between the wealthy and the poor in this country were not exactly unnoticeable. I had personal knowledge of conditions on the lower end of the scale during my boyhood in Broken Bow, Nebraska. We did not have any firsthand knowledge of how the Astors and the Vanderbilts lived, but we read about it. We also read the literature of social protest - the works of writers such as Upton Sinclair, Frank Norris, and Theodore Dreiser.

Those works had a beneficial influence in so far as they stimulated corrective action against some of the ugly sores in our society. However, few would argue today that we have reached our present degree of affluence because we eliminated or greatly reduced the unequal distribution of incomes. We are better off today chiefly because we concentrated our efforts on raising productivity. One way we did this was by developing mass production, supported by mass consumption. Men like Henry Ford were lavishly rewarded for their contribution to this development. However, their great personal fortunes were picayune in comparison with the tremendous increase in the productive power of American labor,

and the resulting improvement in the standard of living, that they made possible.

Nothing in Latin America impressed me more than the need and the scope for improvements in the productivity of labor, both urban and rural. This, I feel, can make a much more important contribution to raising living standards there than can measures to redistribute existing income. The cake needs to be made bigger - just recutting it will not do any good. Indeed, there are cases in which the effects, on productivity, of income redistribution are likely to be harmful.

Again, this is not an original idea, but it is also one that seems to have gotten lost in Latin America. Like correcting attitudes about the desirability of inflation, this is not something you can accomplish simply by making government loans or grants. It requires work in the area of ideas. For example, you have to convince a very large number of people that they will get real improvements in their living standards faster if they try to maximize their productive effort than if they try to maximize their money income while minimizing their output. Well-organized groups can use their bargaining power to improve their own position at the expense of the unorganized up to a point, but in Latin America the tendency has been to grant the wage increases, the fringe benefits, the early retirement privileges, et cetera, to everyone through legislation. This often means that no group gains at the expense of any other, but rather that the whole society loses because productivity suffers.

I came away from Latin America with stories ringing in my ears of the great problems created by inefficient operations that could not be put in order because of laws and regulations restricting the dismissal of workers - even the inefficient ones. In one country, a bank was prevented from dismissing two employees who had been caught embezzling funds! In Peru, a country plagued with underemployment, I found costly machinery being used instead of unskilled labor only because complex legislation makes it easier for employers to work with machines than with men.

Elsewhere, I saw large amounts of capital being used to build plants which can operate profitably only as long as the government continues to provide them with guaranteed markets in which they can sell at high prices. The idea of stimulating mass consumption by bending every effort to bring the cost of manufactured goods within the grasp of the masses is not only ignored, it is flouted. The governments themselves must share the blame for this because of tax and tariff policies that make goods much more expensive than they ought to be.

This applies not only to luxuries, but even to some obvious necessities - matches, for example. I was particularly aware of this because I am a pipe smoker. Never before have I been in an area where matches were so scarce and of such poor quality. People joke about this. In one country they told of the fellow who took a match from a full box, lit it, and immediately threw the box away. Asked why he was so wasteful, he replied, "Oh, everyone knows there is only one in a box that works."

This exaggeration illustrates a point of some significance. There is something cockeyed about policies that make the sale of poor matches at exorbitant prices a means of helping to finance the losses incurred by a government-owned plant to produce, for instance, poor quality steel which is also sold at exorbitant prices.

I began this discussion by pointing out that the Venezuelan case suggested that economic growth per se was not the solution to the problem of political instability in Latin America, and I then went on to criticize some of the accepted solutions on the ground that they do not seem to be the measures best suited to the promotion of economic growth. I must clarify this seeming inconsistency.

I am in favor of economic growth; very much so. I want to see misery alleviated; not because it will serve our political interests, but because it is in the interest of the people of Latin America. I am also in favor of social justice, and for the same reason. However, one of the basic difficulties there is that popular concepts of social justice are often in

serious conflict with some of the basic principles of economics. A country may have very impressive growth, as Venezuela has had, and still suffer from political instability because a substantial portion of the population believes that the political and economic organization of society is unjust. On the other hand, if the government succumbs to popular conceptions of social justice that are economically ruinous, as in Argentina under Peron, political stability is not likely to be attained either. I am afraid that we have not yet mastered the art of bending basic economic law to meet our own wishes.

This suggests that the Latin American problem has to be approached in the direction of modifying popular conceptions of what is economically and politically just. Governments, whether democratic or dictatorial, will have difficulties if they try to pursue economic policies that are sound but highly unpopular. But they will have no easier road if they adopt policies that are popular but economically unsound.

I believe that what this adds up to is that the proper diagnosis for Latin America is not capital malnutrition and income maldistribution. Rather, it is a combination of endemic economic miscomprehension, a widespread acceptance of certain notions of social justice that do not square with the economic realities, and a high degree of inertia.

If one accepts this diagnosis, it is obvious that high on the list of remedies must be one that will stimulate a reformation of ideas and of spirit. There is a need to somehow infuse a spirit of drive into a large part of the population of the southern hemisphere. There is a great need for something akin to the spirit that impelled our forebears in this country to pioneer the wilderness and open up the west, suffering not only personal discomfort but risking death to carve out a better life for themselves and their families by their own sweat and sacrifice.

What worries me is that we do not really know how to go about this. So far as I know, we have not carried out experiments or research to try to find out whether it can be

done. I suspect that the closest we have come to it is in the Peace Corps program. I did not have an opportunity to observe the Peace Corps at work, but I did hear favorable reports on its activities in Latin America. This approach may be one way in which some of the necessary changes might be stimulated.

Actually, the remedial task in Latin America, under my diagnosis, is so staggering that there is a strong temptation to throw up one's hands and look (as I fear we have done too frequently in the past) for diagnoses that call for simpler remedies - remedies, for example, that can be provided from an open pocketbook. However, in my view, the danger is so great that there are two things we cannot really afford: first, failure to comprehend the nature and the scope of the problem, and second, failure to exercise all our ingenuity and imagination - as well as our compassion - in the endeavor to aid our Latin American neighbors.

During the month of October 1962, Governor J. L. Robertson of the Federal Reserve System, visited eight Latin American countries--Venezuela, Brazil, Argentina, Chile, Peru, Colombia, Panama and Mexico. His remarks on the economic problems of Latin America as he saw them in the course of this trip were delivered before a meeting of the National and State Bank Divisions of the American Bankers Association in Washington, D. C., on December 10, 1962. In view of the favorable reaction they have evoked, we feel that the regular readers of Latin American Economic Developments may wish to see the text of Governor Robertson's remarks. Except for a portion that did not deal with Latin America, the text is reproduced in full below.

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That we are still a very long way from accomplishing this was impressed upon me strongly in the first country I visited - Venezuela. Here is a country that is obviously experiencing real difficulties. The first day I was in Caracas the newspaper headlines blazoned the news of the temporary seizure of a village just a few miles from Caracas, and the slaughter of its police force, by a band of communists. The week after I left, the Tamanaco Hotel where I had stayed was bombed and badly damaged. More recently, bombings have wreaked heavy destruction on Venezuela's oil and pipeline facilities. The government has been forced to declare martial law and suspend civil liberties.

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I might note that thirty or forty years ago, not to mention the present, the contrasts between the wealthy and the poor in this country were not exactly unnoticeable. I had personal knowledge of conditions on the lower end of the scale during my boyhood in Broken Bow, Nebraska. We did not have any firsthand knowledge of how the Astors and the Vanderbilts lived, but we read about it. We also read the literature of social protest - the works of writers such as Upton Sinclair, Frank Norris, and Theodore Dreiser.

Those works had a beneficial influence in so far as they stimulated corrective action against some of the ugly sores in our society. However, few would argue today that we have reached our present degree of affluence because we eliminated or greatly reduced the unequal distribution of incomes. We are better off today chiefly because we concentrated our efforts on raising productivity. One way we did this was by developing mass production, supported by mass consumption. Men like Henry Ford were lavishly rewarded for their contribution to this development. However, their great personal fortunes were picayune in comparison with the tremendous increase in the productive power of American labor,

and the resulting improvement in the standard of living, that they made possible.

Nothing in Latin America impressed me more than the need and the scope for improvements in the productivity of labor, both urban and rural. This, I feel, can make a much more important contribution to raising living standards there than can measures to redistribute existing income. The cake needs to be made bigger - just recutting it will not do any good. Indeed, there are cases in which the effects, on productivity, of income redistribution are likely to be harmful.

Again, this is not an original idea, but it is also one that seems to have gotten lost in Latin America. Like correcting attitudes about the desirability of inflation, this is not something you can accomplish simply by making government loans or grants. It requires work in the area of ideas. For example, you have to convince a very large number of people that they will get real improvements in their living standards faster if they try to maximize their productive effort than if they try to maximize their money income while minimizing their output. Well-organized groups can use their bargaining power to improve their own position at the expense of the unorganized up to a point, but in Latin America the tendency has been to grant the wage increases, the fringe benefits, the early retirement privileges, et cetera, to everyone through legislation. This often means that no group gains at the expense of any other, but rather that the whole society loses because productivity suffers.

I came away from Latin America with stories ringing in my ears of the great problems created by inefficient operations that could not be put in order because of laws and regulations restricting the dismissal of workers - even the inefficient ones. In one country, a bank was prevented from dismissing two employees who had been caught embezzling funds! In Peru, a country plagued with underemployment, I found costly machinery being used instead of unskilled labor only because complex legislation makes it easier for employers to work with machines than with men.

Elsewhere, I saw large amounts of capital being used to build plants which can operate profitably only as long as the government continues to provide them with guaranteed markets in which they can sell at high prices. The idea of stimulating mass consumption by bending every effort to bring the cost of manufactured goods within the grasp of the masses is not only ignored, it is flouted. The governments themselves must share the blame for this because of tax and tariff policies that make goods much more expensive than they ought to be.

This applies not only to luxuries, but even to some obvious necessities - matches, for example. I was particularly aware of this because I am a pipe smoker. Never before have I been in an area where matches were so scarce and of such poor quality. People joke about this. In one country they told of the fellow who took a match from a full box, lit it, and immediately threw the box away. Asked why he was so wasteful, he replied, "Oh, everyone knows there is only one in a box that works."

This exaggeration illustrates a point of some significance. There is something cockeyed about policies that make the sale of poor matches at exorbitant prices a means of helping to finance the losses incurred by a government-owned plant to produce, for instance, poor quality steel which is also sold at exorbitant prices.

I began this discussion by pointing out that the Venezuelan case suggested that economic growth per se was not the solution to the problem of political instability in Latin America, and I then went on to criticize some of the accepted solutions on the ground that they do not seem to be the measures best suited to the promotion of economic growth. I must clarify this seeming inconsistency.

I am in favor of economic growth; very much so. I want to see misery alleviated; not because it will serve our political interests, but because it is in the interest of the people of Latin America. I am also in favor of social justice, and for the same reason. However, one of the basic difficulties there is that popular concepts of social justice are often in

serious conflict with some of the basic principles of economics. A country may have very impressive growth, as Venezuela has had, and still suffer from political instability because a substantial portion of the population believes that the political and economic organization of society is unjust. On the other hand, if the government succumbs to popular conceptions of social justice that are economically ruinous, as in Argentina under Peron, political stability is not likely to be attained either. I am afraid that we have not yet mastered the art of bending basic economic law to meet our own wishes.

This suggests that the Latin American problem has to be approached in the direction of modifying popular conceptions of what is economically and politically just. Governments, whether democratic or dictatorial, will have difficulties if they try to pursue economic policies that are sound but highly unpopular. But they will have no easier road if they adopt policies that are popular but economically unsound.

I believe that what this adds up to is that the proper diagnosis for Latin America is not capital malnutrition and income maldistribution. Rather, it is a combination of endemic economic miscomprehension, a widespread acceptance of certain notions of social justice that do not square with the economic realities, and a high degree of inertia.

If one accepts this diagnosis, it is obvious that high on the list of remedies must be one that will stimulate a reformation of ideas and of spirit. There is a need to somehow infuse a spirit of drive into a large part of the population of the southern hemisphere. There is a great need for something akin to the spirit that impelled our forebears in this country to pioneer the wilderness and open up the west, suffering not only personal discomfort but risking death to carve out a better life for themselves and their families by their own sweat and sacrifice.

What worries me is that we do not really know how to go about this. So far as I know, we have not carried out experiments or research to try to find out whether it can be

done. I suspect that the closest we have come to it is in the Peace Corps program. I did not have an opportunity to observe the Peace Corps at work, but I did hear favorable reports on its activities in Latin America. This approach may be one way in which some of the necessary changes might be stimulated.

Actually, the remedial task in Latin America, under my diagnosis, is so staggering that there is a strong temptation to throw up one's hands and look (as I fear we have done too frequently in the past) for diagnoses that call for simpler remedies - remedies, for example, that can be provided from an open pocketbook. However, in my view, the danger is so great that there are two things we cannot really afford: first, failure to comprehend the nature and the scope of the problem, and second, failure to exercise all our ingenuity and imagination - as well as our compassion - in the endeavor to aid our Latin American neighbors.