

Karl R. Bopp—  
Central Banker  
The Federal Reserve as a  
Living Institution: A  
Prescription for The Future.



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## ABOUT THIS ISSUE

After twelve years as the top executive team of the Federal Reserve Bank of Philadelphia, Karl R. Bopp, President, and Robert N. Hilker, First Vice President, retired March 1, 1970. On that same date, David P. Eastburn became President and David C. Melnicoff took over the responsibilities of First Vice President.

As the guard is being changed, it is appropriate that tribute be paid to the past and that a renewed focus be made on the

future. In the first of these two articles, David P. Eastburn gives a very personal view of his highly distinguished predecessor, Mr. Bopp. In the second, he presents a rather impressionistic view of the Federal Reserve as a living institution and a prescription for the future. These essays have been selected from *Men, Money and Policy*, published in limited edition by the Federal Reserve Bank of Philadelphia in honor of Karl R. Bopp.

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# Karl R. Bopp— Central Banker by David P. Eastburn

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There is a story about Mark Twain to the effect that his wife once tried to break him of profanity by swearing in his presence at every opportunity. Twain's reaction was simply that "she knew the words but didn't quite have the tune." An attempt to summarize Karl Bopp's beliefs as an economist and central banker is certain to produce the same results. I have been a student of Karl Bopp's for over a quarter of a century, for a short time in the University of Pennsylvania classroom, and the rest at the Federal Reserve Bank of Philadelphia. During the same period, I have also been, if I can make the distinction, a student of Karl Bopp. The subject has been at once the most fascinating and most difficult I have ever tackled; the results have been the most inconclusive.

One reason is that Karl is many persons. As an economist and central banker, Karl has sometimes been an observer, sometimes a participant, and it is as hard for a biographer to keep the two roles straight as it often must have been for him. Early training inculcated in Karl a lifelong fascination for central banking. At Missouri he probed deeply into official records to come up with an insightful view of the agencies of Federal Reserve policy. In subsequent years he has kept detailed notes on index cards of the day-to-day unfolding of momentous events in Federal Reserve history, all the while participating in important policymaking decisions. The combination of the two personalities—one recording and analyzing with great objectivity, the other debating, deciding, defending, and rationalizing with considerable subjectivity—has made Karl a much more complex person than many of his colleagues. Most of the time it has made for strengths, as I intend to demonstrate; but when the two motivations were at war, it could be divisive.



Similarly, Karl Bopp has been both a deeply emotional and an intensely intellectual man; the two characteristics cannot be disentangled. It is as an intellectual that Karl has had his greatest impact, however, and, I suspect, as he would wish to be judged. All of us who have worked with him have had reason to be awed by—indeed, have on occasion been impaled by—Karl's brilliantly logical mind. It is a mind intolerant of, although through self-discipline patient with, sloppy thinking. It is a cultivated mind, quite as likely to produce an argument from Aristotle or a verse by T. S. Eliot as a subtlety of Wicksell. Of all his associations, I suspect Karl values most highly his membership in the American Philosophical Society.

And it is a scholarly mind. Karl has never felt comfortable with a ghost writer. The list of his own publications, however, is not long; a number of studies emerged in the Missouri days, several more in the 1940's and 1950's during the period in research at Philadelphia, practically none during his presidency of the Bank. But all are the product of deep and careful thought, many of back-breaking research. Perhaps there is, somewhere, a student of central banking who has pored over as many reports, minutes, hearings, and memoranda involving as many central banks as has Karl, but if so I am not aware of his existence; and certainly he has not been a practicing central banker.

This is the unique combination—scholarly research of the major central banks in critical periods, and day-to-day confrontation with current problems of Federal Reserve policy—which has shaped Karl Bopp's philosophy. It has, above all, given him a strong sense of history. By habit, almost compulsion, Karl tends to approach any problem from the direction of historical experience. The result is a curious blend of assurance and skepticism, confidence, and

humility.

Let me illustrate. In the course of his career, Karl has seen a severe depression, several recessions of varying intensity, and some periods of inflation. From all this he has emerged, so far as I can tell, with no fixed view about the future course of the American economy. True, he has observed many times that something very different happened after World War II than after earlier major wars: the economy has not experienced a decline in prices, and this does signify a basic change in the economy and in public policy. But to say that depressions are ruled out henceforth or that the major problem of the future is chronic inflation is to go too far. History demonstrates that nothing—prosperity, inflation, chronic stagnation, dollar scarcity, or dollar glut—is inevitable. This can be a hopeful view: the problems of the moment can't last forever. Or it can be a pessimistic view: despite all we have learned about how the economy works and how to shape it to our ends, things can happen which we don't anticipate.

Above all it is a humble view. Humility is much in evidence in Karl's most revealing "Confessions of a Central Banker."<sup>1</sup> "The simple truth," he says, "is that no one comprehends enough to be an expert in central banking." This confession of ignorance apparently reflects an evolution from Karl's days in academia when, as he describes himself, he was an intellectual grandson of Irving Fisher. Through Fisher's students, James Harvey Rogers and Harry Gunnison Brown, he learned of the importance of money as a determinant of economic activity. But in the course of time, exposure to the realities of policymaking and recognition of the

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<sup>1</sup>Karl R. Bopp, "Confessions of a Central Banker," *Essays in Monetary Policy in Honor of Elmer Wood*, Ed. Pinkney C. Walker (Columbia, Mo.: University of Missouri Press, 1965), p. 12.



chaotic state of monetary theory have led him to distrust (although not, he says, without a twinge of conscience) the monetarists' explanations of economic behavior and their mechanistic approaches to policy. It is clear from his "Confessions," however, that his view of the unsatisfactory state of knowledge is not a counsel of despair, but of patience. It is a challenge to research, an invitation to be tolerant of the ideas of others.

And despite what appears to be a thoroughgoing agnosticism about the monetary process, Karl is not without foundations on which to build his view of monetary policy. One of the firmest of the foundations is a strong sense of the role of markets. As he has come to distrust rules of thumb and formulae, he has become impressed by the complex workings of markets. This has led him, on the one hand, to advocate a great deal of discretion in the execution of policy. For example, he has always shrunk from quantifying instructions to the manager of the Open Market Account. Close observation of the money market has convinced him that the best person to determine the *tactics* of policy is the man on the scene, in the thick of the market. As a participant in determining the *strategy* of policy, Karl has tended to be brief and concise in his presentations before the Open Market Committee and has avoided the semantic exercises that sometimes characterize Committee discussions.

On the other hand, his view of markets has convinced him of the fallibility of money managers who attempt to usurp markets' functions. Selective credit controls have always been distasteful, both on philosophical and practical grounds. Voluntary credit restraint has smacked of the real-bills fallacy. As Reserve Bank President, Karl has resisted pressures to lecture commercial bankers about credit restraint, not

only because his natural modesty has made it difficult to do this, but also because he has not been willing to superimpose his judgments as a central banker on theirs as commercial bankers. He has preferred to let monetary policy speak for itself through the marketplace.

As a non-interventionist, Karl has been pretty much in the mainstream of Federal Reserve tradition. But in a number of other respects he has been an individualist. Three examples come to mind, one having to do with objectives of policy, a second with instruments, and a third with agencies. All are illustrative of his broad, historical approach to policy problems.

Some years ago, as Karl examined the various objectives of monetary policy over time, he saw clearly the conflicts that often exist.<sup>2</sup> This was before the term "trade-off" became commonly used to describe the problem. More recently he has taken exception to the conventional wisdom of including economic growth as an objective of monetary policy. His position has been that monetary policy has relatively little to do with the germinal elements of growth; that an appropriate policy will produce maximum sustainable use of available resources and this, in itself, is a large contribution to growth.

As to the instruments of policy, his views have been influenced strongly by an intensive analysis of operations of the German Reichsbank from its foundation until World War I.<sup>3</sup> Despite the facts that the Reichsbank had no information on the volume of reserves, could not achieve a given level of reserves, and dealt with a banking system whose reserve ratio varied considerably over time, it nevertheless achieved its basic

<sup>2</sup> Karl R. Bopp, "Central Banking Objectives, Guides, and Measures," *The Journal of Finance*, Vol. IX, No. 1 (March 1954) pp. 12-22.

<sup>3</sup> Karl R. Bopp, "Die Tätigkeit der Reichsbank von 1876 bis 1914," published in Germany only, *Weltwirtschaftliches Archiv*, 1954.

objective. While he has not advocated that the Federal Reserve System actually try to do without reserve requirements as an instrument of policy, still, Karl has concluded that the ultimate power of the central bank lies in its ability to create and destroy money and reserves, at times supplying more liquidity and at other times less liquidity than commercial banks wish to hold. A fixed reserve ratio is not an essential ingredient of monetary policy.

Finally, Karl for years has been puzzling over the proper relationship of the Federal Reserve and Government. And although he is still rather tentative in his conclusions, he has arrived at a general position that may seem heretical to staunch defenders of "independence." Because he has become convinced that monetary policy must be part of a coordinated economic policy of Government, he believes that in the rare event of an irreconcilable conflict, the central bank must give way; the central banker must resign. Furthermore, in such a situation, the Government, perhaps by joint resolution of Congress, should give clear directions to the central bank as to how to proceed. Karl has arrived at this view not only because such an arrangement is an orderly way to fix responsibility, but also because "independence," carried to its logical extreme, is undemocratic. And while such a position runs the risk that the people may be "wrong," this is likely only in the short run; we must have faith that the democratic process will work in the long run. Finally, his position

means that the central bank must earn its "independence." Only by demonstrating that it is right most of the time can it build the public support which enables it to persuade Government to its way of thinking. With that support, the central banker's power of resignation becomes a potent instrument indeed.

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How to evaluate the contribution of a man? In some cases it may be primarily by written works, in others by policy actions. In the case of Karl Bopp, neither criterion is determining. His contribution, I believe, lies primarily in the impact of these ideas and his personality on people with whom he has worked. In the policy area, he has not been one to dominate deliberations. But he has spoken up at crucial times with an authority that has brought fresh insight to the discussion. Above all, his influence on staff—and here I speak with particular knowledge and feeling—has been profound. He has transmitted a philosophy of freedom in the pursuit of ideas to all of us who have worked with him. And he has made us all aware that monetary policy—as well as everything else of any importance, for that matter—is a human process.

Perhaps the most fitting way to summarize is to relate part of a conversation between us not long before Karl's retirement. In a reflective mood, he wondered whether, after all, perhaps he should have remained in teaching. My reply was that he has never left it.



# The Federal Reserve as a Living Institution: A Prescription for the Future

by David P. Eastburn

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To one who has been part of an organization for any length of time, observing and sharing its successes and failures, its manic and depressive moods, its victories and defeats, a question of enduring fascination is what keeps the thing alive and well. What are the ingredients of a living institution?

The Federal Reserve is now well into its second half century. It is a mere adolescent compared with the Bank of England, but has been around considerably longer than most central banks. In this time it has established a record and developed a personality which I propose to examine here—rather impressionistically, and, of course, non-objectively—as a sort of case example of a living institution.

In search of guidance, one tends to look for a general theory of the rise and fall of institutions. Many writers, in fact, have touched on various aspects of the problem. Bernstein has detected a kind of life cycle in regulatory commissions in the United States.<sup>1</sup> Kenneth Boulding has distinguished three ages of an institution, with varying effects upon what he calls its legitimacy.<sup>2</sup> John Gardner has offered much inspira-

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<sup>1</sup> According to his analysis, the typical progression is from gestation, a phase stimulated by public pressure for reform; to youth, a chaotic period of conflict and enthusiasm; to maturity, a stage of high professionalism with policies and procedures well-established and adhered to; and finally to old age, a condition of passive conservatism and inefficiency. Marver H. Bernstein, *Regulating Business by Independent Commission* (Princeton: Princeton University Press, 1955), pp. 74-102.

<sup>2</sup> He points out that institutions build up legitimacy “just by sticking around,” but that the function may be nonlinear. “When things are new, they have the special legitimacy of babies, young people, or the new fashion. At a certain point they become middle-aged or old-fashioned and legitimacy declines sharply. Then as time goes on further they become antiques and legitimacy increases once again.” Kenneth E. Boulding, “The Legitimacy of Central Banks,” *Fundamental Reappraisal of the Discount Mechanism* (Washington, D. C.: Board of Governors of the Federal Reserve System, July 1969), pp. 4-5.

tional insight on self-renewal.<sup>3</sup> C. Northcote Parkinson has analyzed the decline of organizations, a phenomenon which he attributes to a disease—"injelititis."<sup>4</sup> These observations are helpful but, as far as I am aware, the definitive work on growth and decline of organizations remains to be written.

Observation of the Federal Reserve System leads me to believe that three factors go far to explain its past and, more importantly, could have a profound influence on its future. These are: (1) the values it holds; (2) the professionalism of its personnel; and (3) the nature of the decisionmaking process.

## VALUES

**Proposition 1: The Federal Reserve System will be strong and effective in the long run to the extent that the values which govern its actions are in accord with the values held by the society which it serves.**

<sup>3</sup> John W. Gardner, *Self-Renewal: the Individual and the Innovative Society* (New York: Harper & Row, 1963).

<sup>4</sup> This is "the disease of induced inferiority" caused by the fusing of incompetence and jealousy to produce a new substance, "injelitance." An infected individual can spread the disease to an entire organization, systematically eliminating all people of ability. The first phase of the disease is characterized by a too-low standard of achievement; the second by smugness as these aims are achieved; and the third by apathy. Cases of recovery are rare, but occasionally an organization recovers because some individuals have developed a natural immunity. "They conceal their ability under a mask of imbecile good humor. The result is that the operatives assigned to the task of ability-elimination fail (through stupidity) to recognize ability when they see it. An individual of merit penetrates the outer defenses and begins to make his way toward the top. He wanders on, babbling about golf and giggling feebly, losing documents and forgetting names, and looking just like everyone else. Only when he has reached high rank does he suddenly throw off the mask and appear like the demon king among a crowd of pantomime fairies. With shrill screams of dismay the high executives find ability right there in the midst of them. It is too late by then to do anything about it. The damage has been done, the disease is in retreat, and full recovery is possible over the next ten years." C. Northcote Parkinson, *Parkinson's Law* (Boston: Houghton Mifflin Co., 1957), p. 82.

Although the concept of values often carries with it ethical connotations, and although moral purpose may be essential to the strength of an organization,<sup>5</sup> it is not necessary for my thesis to go this route. By values I have in mind simply the "norms or principles which people apply in decision-making, that is, the criteria they use in choosing which of alternative courses of action to follow."<sup>6</sup>

In a very broad sense, however, the *basic* value, or criterion, governing decisions of Federal Reserve authorities *does* have strong ethical connotations. The fundamental mission of the Fed is to promote the fullest sustained realization of the nation's economic potential. A similar goal, of course, is held by most individuals in American society. For better or worse, the typical American spends a great proportion of his working and "leisure" hours striving to "make it"—trying to put his talents and resources to the best possible use as he sees it. The fact that the Fed's objective is in close conformity with a basic value also held by society lends great strength to the Federal Reserve's position in society—its legitimacy, as Boulding would say.

A critical question for the future, however, is whether this materialistic view of human endeavor will continue to apply. From the time of the Greeks, philosophers have held out as the highest achievement of Man his self-realization, the fullest development of his potential. Even in this context, the Fed's basic value is in gen-

<sup>5</sup> Chester Barnard, in his classic study of the functions of the executive, for example, maintains that: "Organizations endure . . . in proportion to the breadth of the morality by which they are governed. This is only to say that foresight, long purposes, high ideals, are the basis for the persistence of coöperation." Chester I. Barnard, *The Functions of the Executive* (Cambridge, Mass.: Harvard University Press, 1958), p. 282.

<sup>6</sup> Philip E. Jacob, "Values Measured for Local Leadership," *Wharton Quarterly*, Vol. III, No. 4 (Summer 1969), p. 31.



eral conformity to society's; but, as and if society changes—perhaps as and if the “new generation” carries its less materialistic view of life with it into later years—it is possible that the relationship will become less strong.

This raises an obvious corollary to Proposition 1: namely, that **the Federal Reserve's values must change as society's values change.**

Barnard has made the point that an organization disintegrates if it fails to achieve its purposes; but it destroys itself if it does achieve them.<sup>7</sup> What it must do is constantly seek new goals. These, in the case of the Federal Reserve, should be new goals which society is seeking.

In the past, the Federal Reserve System has succeeded, and succeeded remarkably well in view of the narrow charge given it by Congress, in updating its objectives. Indeed, had the Fed been content with a literal interpretation of its original assignment to provide an elastic currency, etc., it would not be important enough to bother about today. Response to changing needs may not always have been as prompt, full, and voluntary as everyone might like, new objectives may not always have been achieved effectively, but on the whole I do believe the Fed has renewed itself over the years by broadening its objectives and values.

Two questions, however, arise about the future. One I have already suggested: if the public at large is shifting its emphasis from materialistic-economic concerns to humanistic-social concerns, how will the Fed respond? It is dangerous, of course, to extrapolate a short-run movement into a long-run trend, but it is clear that some such shift has been in the making. The legitimacy of the Federal Reserve System may well hinge importantly on how its officials react.

Economic policies carried out by the Federal

Reserve will have very great social impacts as they always have. Decisions in trading off unemployment against price increases do not simply involve statistics expressed in a Phillips curve, but impacts on human lives. The social costs of unemployment among Negro teenagers, for example, must be weighed against those of inflation for pensioners. Federal Reserve authorities know this—they are not bloodless computers—but they may have to give more consideration to this kind of calculation in the future than in the past. Moreover, the Fed traditionally has resisted pressures to deal with specific problems in specific parts of the economy. Would it be wise, for example, to devise some way of channeling Federal Reserve funds into the ghetto? The role which the Fed is to play in our society in the future may well depend on responses to and anticipation of pressures like this.

A second question for the future flows from this thought: how much weight will the Federal Reserve give to the value of freedom in trying to achieve new objectives? The very creation of the Federal Reserve System was an act of intervention, a departure from *laissez-faire* resisted by conservative elements at the time. Nevertheless, the philosophy under which the System has operated for the most part since has stressed freedom of the market place, and the tradition of minimum intervention in markets served the Fed well for many years.

Freedom, however, must be put in a relative context, relative to other values. This, in fact, is what society has been doing, especially since the 1930's. Society has tolerated, indeed demanded, increasing intervention by public authorities in markets in order to get greater security, justice, and other values. There is no evidence to indicate that this trend will not continue.

<sup>7</sup> *Op. cit.*, p. 91.



In this environment the Fed will find itself facing a dilemma: its stated philosophy is non-interventionist; its practice is increasingly interventionist. A review of history indicates that Federal Reserve authorities almost invariably resort to unorthodox "gimmicks" when crises arise and pressures become intense.<sup>8</sup> This behavior might be excused as necessary in rare and difficult circumstances, but I would guess that the Fed will be confronted more often, not just in crises, with the need to innovate *via* special types of controls. Banks, much more innovative than ever before anyway, have been further stimulated by Regulation Q to explore new sources of funds. As the Fed, attempting to restrain the expansion of money and credit, closes one loophole after another, banks promptly discover new ones.

What to do about this schizophrenia? If my prediction is correct, the Federal Reserve will have to reconsider its philosophy of nonintervention in markets. This, I believe, would bring philosophy into conformity with practice and make possible a rational and consistent approach to regulation rather than one of *ad hoc* loophole plugging. And it would bring philosophy more nearly into the mainstream of what society now wants. The public demands an increasingly high performance of the economy and of public policymakers responsible for the economy. It is less tolerant of unemployment and alert to the slightest tendency toward recession. At the same time, it is increasingly concerned about inflation. It is more interested in how things are distributed—unemployment among disad-

<sup>8</sup> Some of these devices include "direct action" in the late 1920's, margin requirements, moral suasion, Regulations W and X, "Operation Twist," the September 1, 1966, letter from the Federal Reserve to member banks. David P. Eastburn, "Uneven Impacts of Monetary Policy: What to Do About Them?" *Business Review*, Federal Reserve Bank of Philadelphia, January 1967, p. 21.

vantaged groups, tax avoidance by the wealthy, the impact of tight money on housing.

All of this has greatly reduced margins of error for policymakers. Their response has been to try to "fine tune" the economy, not only by making small changes as promptly as possible to influence overall aggregates, but by dealing in specific ways with specific parts of the economy. The public at large has no interest in fine tuning *per se*, but the influence of its many growing and conflicting demands—and this, I believe, is an irreversible influence—is to force policymakers to fine tune.

Many experts believe that fine tuning is beyond our capability, and certainly much of the 1960's provides ample evidence to support this view. Therefore, they maintain attention should be directed to making markets more efficient by removing impediments to competition. For example, rather than imposing a ceiling on interest rates on time and savings deposits and devising special techniques for channeling funds into mortgage markets, efforts should be devoted to removing usury ceilings, liberalizing restrictions on competition among various kinds of institutions in various kinds of markets, and the like.

What economist, brought up in the competitive tradition, could argue against such a course? The only problem is that the likelihood of success is low. Vested interests are so entrenched that results are bound to be slow and incomplete. Much as we all would like markets to be free (at least in the abstract), the likelihood is that many serious impediments will remain. Meanwhile, the public continues to exert pressure which forces policymakers to fine tune.

It may be that public officials, including those at the Federal Reserve, cannot deliver what the public wants. Attempts to intervene in markets, efforts to fine tune, may fail because of human



frailty. Perhaps the only evidence that can be brought to bear on this is history. I believe history shows that public policy can perform and has performed at ever-higher levels of competency. There is no reason to believe we have reached the ultimate. Today's fine tuning becomes tomorrow's orthodoxy.

The public, of course, should be made aware of the limited state of the art at any given time so that it does not demand the utterly impossible. This thought suggests a second corollary to Proposition 1: **the Federal Reserve's values should be clearly made known to and understood by society.**

Some kinds of institutions, like the church, may thrive for centuries on values which their constituents are asked to accept on faith. For most institutions, however, mystique, charisma, and ritual, although powerful forces for legitimacy over a short period, prove to be weak reeds in the end.<sup>9</sup> Federal Reserve authorities undoubtedly have yielded to the temptation to lean on them many times in the past, but chances of getting away with this are fast disappearing, if not already gone. The public is too sophisticated.

As the Fed confronts its sophisticated constituents, it may well find the going easier in some respects, more difficult in others. Up to a point, a more knowledgeable public should be more sympathetic with what the Federal Reserve is trying to do. Inflation is a good example. Proposition 1 should not be interpreted to mean that Federal Reserve authorities should

supinely adopt inflation as an objective simply because society is ill-informed about its evils. The Fed must try to influence society's choice of values as well as adapt to them. The problem of overcoming inflation should be easier as the public becomes increasingly sophisticated.

In some respects, however, the Fed may find communications more difficult. It may not be so hard to enunciate and gain society's acceptance of the *basic* values governing the Fed's policies, but at a more technical level the criteria for action will be hard to explain and sell. Nor are prospects for success enhanced by history. The Federal Reserve all too frequently has tended to devise simplistic rationales for policy, develop a vested interest in them, and nurture them long past the period of whatever validity they may have had. The terms "productive credit," "pegs," "bills only" perhaps recall a few instances.

Confronted by an increasingly sophisticated public, the Fed may find the best course is to admit unashamedly that it has, as yet, no adequate theory of how monetary policy works. I say unashamedly because, although Federal Reserve economists should have been working much harder and longer on the problem than they have, no one else has an adequate theory either. If the Fed assumes a posture of humble agnosticism, it is likely to come out better in the long run. And it should feel perfectly at home with such a posture in today's relativist world distrustful of the old absolute values.

A third corollary which flows from this is that **the Federal Reserve must at all times be alert to society's changing values.**

Riesman, Glazer, and Denney, in their influential study, *The Lonely Crowd*, drew the distinction between "inner-directed" and "other-directed" personalities. An inner-directed person is governed by absolute values and tradi-

<sup>9</sup> Boulding suggests that legitimacy of central banks might be fostered "by preserving a certain air of charismatic obscurity about their operations. Their officers might even take to wearing gowns and robes and their public pronouncements might be couched in even more mysterious and impressive language than they now use." *Op. cit.*, p. 20. He suggests, however, that in the long run an important source of legitimacy is payoff; an institution must provide good terms of trade with those who are related to it. (p. 3)



tion. An other-directed person sees things in more relative terms and is influenced more by his peers.

If the Federal Reserve is to maintain values in conformity with those held by society, it will need to be more other-directed than in the past. This is not just a matter of information, but of attitude. Other-direction fosters an attitude of openness to change, of flexibility.

And it is a matter of involvement. As the economy becomes more and more complex, the Fed is increasingly tempted to withdraw into its specialty of monetary policy. Good arguments can be made for this course, but the institution will be stronger, I believe, if it is involved in other matters as well. Obviously, there must be limits. Not only could the Fed become over-committed and its efficiency impaired, but excessive involvement could produce severe conflicts of values and objectives, confusion, and a general weakening of purpose. On balance, however, the greater danger is that the Fed will become aloof. Such activities as bank supervision and truth in lending, troublesome though they may be, help to give it a sense of what is really going on, insights into the way other institutions really work, and how people are thinking.

A fourth corollary to Proposition 1 is that **the Federal Reserve should have confidence in its values, and its ability to establish them.**<sup>10</sup>

In a recent convention of people concerned about social welfare, one speaker remarked on the attitude of young people toward theology.

If someone holding to the more traditional theology should attend an experimental liturgy on a campus, he would probably be horrified. The songs, the readings, dialogues, prayers, and homily would make as their chief emphasis:

<sup>10</sup> C. R. Whittlesey has argued elsewhere in this volume that for monetary policy to be effective it must be believed in. My point is complementary to his: the Federal Reserve must believe in its policy.

1) how confident we can be that all of the barriers to true human life will be overcome, and 2) the awareness that God has given this task of breaking down barriers to us. The visitor would be sure that the students were guilty of colossal pride and that they had left Christianity far behind for a new humanism.<sup>11</sup>

Today's young people are a remarkable lot, but in at least one important sense they are simply carrying on — in their own distinctive style, of course — what has been a trend over recent decades. In the realm of economics, at least, society has been less and less willing to subject itself to “economic laws” and “market forces” which appear to make the individual a helpless pawn. Not so long ago everyone believed that periodic recessions were inevitable; indeed, good for what ails us. But the Great Depression effectively destroyed the notion that widespread unemployment may be good medicine, and experience in the 1950's and 1960's has raised hopes that even mild recessions may not be inevitable. Society has been coming to believe it is master of its own destiny, and as the “new generation” takes over, this belief is likely to be intensified.

The Federal Reserve is not yet old enough to be preoccupied with its past heritage, but it is entering the dangerous age. Moreover, one can detect at times a latent persecution complex that, if permitted to develop, could prove debilitating. Sensitive to the fact that monetary policy must frequently frustrate people's plans and desires, Federal Reserve officials have been known to refer somewhat plaintively to their lack of popularity. They have said, for example, that the Fed is often in the position of the chaperone who removes the punchbowl just when the party is getting good. Also, in an

<sup>11</sup> Catherine L. Gunsalus, “A Theological and Campus Perspective on Changing Values,” a talk given before the National Conference on Social Welfare, New York City, May 28, 1969, p. 6.



understandable desire to have the public make a proper assessment of credit and blame for public policy, the Fed sometimes tends to underplay the extent of its powers.

And, finally, there is the attrition in membership in the Federal Reserve System, a problem which makes no impression on many economists but which, I believe, is a cancer eating at the morale of the System. The problem is not—at least yet—one of a central bank losing control of the financial aggregates necessary to implement its policy, but one of an organization losing support of a major part of the community. The Federal Reserve does not exist to serve commercial banks, and a good economic case can be made that membership is unnecessary. Nevertheless, membership has been an important aspect of the System for over half a century, and its decline inevitably has a deteriorating effect within the Fed and on its image in the community—not the least of which is the political community. The Federal Reserve does, after all, live in a political world, and, like any public body, needs a strong, concerned, grass-roots support if it is itself to remain vital. The time is overdue to move vigorously and decisively to deal with the inequities created by present requirements for membership. Success in this effort would do much to increase the Fed's confidence in its ability to solve its problems.

A final corollary to Proposition 1 is that **the Federal Reserve must be responsive to the public through the political process.**

Officials of the Federal Reserve System are surrounded by certain safeguards designed to insulate them from the influence of party politics.<sup>12</sup> Yet it is clear that, as public servants, they must be involved in politics in the broad sense; they must respond to the wishes of the

people as expressed through the political process. Mr. Dooley's comment that the Supreme Court watches the election returns, despite its note of cynicism, has real meaning for the Fed. The Federal Reserve is responsible to Congress which, in turn, is responsible to the people; and as the people express their wishes in elections, these wishes must influence Federal Reserve actions.

It is true that history demonstrates abundantly the abuses to which Government can subject money, and that the fathers of the Federal Reserve had this history clearly in mind when they made the Fed independent of the Executive Branch of Government. But they did not make the Federal Reserve independent of Government, and officials of the Federal Reserve System are very much aware of this. They are less inclined to stress their "independence" than are many businessmen and bankers.

Nevertheless, the danger of becoming aloof is ever present.<sup>13</sup> It will be particularly important to guard against this tendency as the Federal Reserve becomes increasingly professionalized.

### PROFESSIONALISM

**Proposition 2: The Federal Reserve will be strong and effective in the long run to the extent that it fosters professionalism in its personnel.**

It is not enough for the Federal Reserve to want what society wants; it must have the technical competence to make good on those wants.

the New Mandarins, in describing Federal Reserve officials. Like the original governors of China, he says, they belong to a "secular priesthood" that is aloof from the people they serve. *New York Times*, April 9, 1969, p. 59.

<sup>13</sup> Bernstein concluded his study of independent regulatory commissions with this warning: "... the theory upon which the independence of the commission is based represents a serious danger to the growth of political democracy in the United States. The dogma of independence encourages support of the naive notion of escape from politics and substitution of the voice of the expert for the voice of the people." *Op. cit.*, p. 293.

<sup>12</sup> Albert L. Kraus has adopted Noam Chomsky's term,



Congress long ago assigned to the Federal Reserve System various tasks of a highly technical nature which Congress felt it could not, and should not, undertake in detail itself. One of the advantages claimed for the regulatory commission approach always has been that it provides a means by which technical skill and expertise can be brought to bear on specific matters. The need for professional know-how is receiving even more attention today as the "knowledge explosion" grapples with the problems of an increasingly complex society.

The Federal Reserve demands professionals of many kinds in many fields—law, personnel, management, accounting, computer technique, to name only a few. In its conduct of monetary policy, it requires professionals in the field of economics, especially monetary economics. A number of years ago, Fed personnel enjoyed outstanding reputations among professional economists; for a decade or so their standing seemed to deteriorate, but more recently it has improved. The Fed's research organizations have always been unsurpassed at intelligence gathering, but deficient at basic research. This gap is being slowly remedied. The greater number of economists among top decision-makers undoubtedly has contributed to the professionalization of the institution.

There are limits to professionalism, however, and this suggests a corollary to Proposition 2: **professionalism must be balanced with other values.**

Gardner indicates that one symptom of stagnation is that "how-to" becomes more important than "what to do"; technique supersedes purpose.<sup>14</sup> One can detect this symptom at times in the Federal Reserve. In open market operations, for example, technique in some respects

becomes so sophisticated that there is danger of losing sight of the objective. Some critics have complained that the finesse of defensive operations gets in the way of an effective monetary policy.

This kind of thing happens because professionalism so often means specialization. The professional becomes intellectually involved in problems; he probes deeper and deeper, often passing the point of diminishing returns. Accordingly, any institution like the Fed must have its generalists, men with broad backgrounds who can see the big picture. If the professional can be both specialist and philosopher, so much the better, but this often is asking too much. This is one reason, undoubtedly, why Karl Bopp, himself an economist, has spoken of the need for some non-economists in top decision-making positions of the Federal Reserve organization. Another may be that the Fed must live and deal with many non-professionals. Reserve Banks must, for example, exist in their local communities. As their staffs become increasingly professional, as they pursue their interest in national monetary policy, there is a danger that they will lose touch, interest, and prestige in their communities.

If properly balanced, however, professionals can bring to the Fed the necessary characteristics for vitality—a creative attitude, a joy in playing with ideas regardless of the outcome—that lead to innovation. But an organization heavily composed of professionals must encourage freedom of thought, the heretical idea, and possess a decisionmaking machinery which gives a true sense of participation. This leads to my last proposition.

## DECISIONMAKING

Proposition 3: **The Federal Reserve System will be strong and effective in the long run to the**

<sup>14</sup> *Op. cit.*, p. 47.



**extent that decisions are made by a pluralistic process.**

John LeCarré, author of spy novels and former member of British intelligence, once made this revealing comment about espionage:

All our societies, even the American one, is administered by an extraordinarily lugubrious apparatus and the very development of events is controlled and paced by a pleasant human slowness and reluctance to take decisions. . . . Now an efficient intelligence service moves at 20 times that pace and is frequently outrunning the decisive capacity of the people who should be controlling it. . . . frequently there is a short-time desirability to produce a revolution in a country X, but if it went through all the committee stages of bumbledom it is quite possible that one would reach a different decision.<sup>15</sup>

Only this, he says, prevents us from moving from one international catastrophe to another.

It might be a backhanded compliment to the Federal Reserve System to say that only its complex decisionmaking machinery prevents it from moving from one monetary disaster to another. For there is no question that decision-making in the Fed—with the Reserve Banks and boards of directors, the Federal Open Market Committee, the Board of Governors, and staff all in the act in one way or another—is complex.

The dangers of multiple direction of an organization are fairly obvious. They include inconsistency of policy, delay, compromise, adherence to *status quo*, dissipation of enthusiasm and vitality, and general inefficiency.<sup>16</sup> It is not clear to me, however, that such results are inevitable. And even if there is a tendency in this direction, the disadvantages should be weighed against the advantages.

The main advantage of the pluralistic process is that decisions are more carefully considered. Each individual brings to bear on the common problem his own set of information, his own particular insights and interests.<sup>17</sup> As our society becomes increasingly complex, indeed, there is a serious question whether any other process will work.<sup>18</sup> Major decisions today require so much technical information, so many different kinds of expertise, that no one individual can be entrusted to make them. Finally, it often may be the case that the pluralistic process not only produces sounder decisions but more innovative ones.<sup>19</sup>

All this suggests a corollary to Proposition 3: **the Federal Reserve should take maximum advantage of its federal structure.**

The fact that the Federal Reserve System resembles the United States Government in some important respects is no accident. The same fears of concentrated power induced the authors of both systems to build in a separation of powers and a federal structure. In both cases, however, the trend has been toward centralization, and a vital question for the future is how much further this trend can go without producing serious weakening.<sup>20</sup>

<sup>15</sup> Charles E. Lindblom makes essentially this argument for what he calls "partisan mutual adjustment." *The Intelligence of Democracy* (New York: The Free Press, 1965).

<sup>16</sup> Philip E. Slater and Warren G. Bennis have concluded that because of growing complexity, "democracy is inevitable." *The Temporary Society* (New York: Harper & Row, 1968).

<sup>17</sup> John Gardner has written: "In an organization with many points of initiative and decision, an innovation stands a better chance of survival; it may be rejected by nine out of ten decision-makers and accepted by the tenth. If it then proves its worth, the nine may adopt it later." *Op. cit.*, p. 68.

<sup>18</sup> Alexis de Tocqueville detected the weakness of centralization almost a century and a half ago: "Centralization imparts without difficulty an admirable regularity to the routine of business; provides skillfully for the

<sup>15</sup> *New York Times*, January 28, 1969, p. 46.

<sup>16</sup> Bernstein has observed all of these in regulatory agencies. *Op. cit.*, pp. 172-174.

The Federal Reserve System has always been stronger for the fact that contributions to policy are made by many people from all parts of the country, not just in Washington. As formulation of monetary policy becomes increasingly difficult, as standards expected of the Fed become ever higher, as the System becomes involved in more and more activities of a complex nature outside of monetary policy *per se*, the Federal Reserve will need to rely increasingly on these contributions.

This is not just a matter of decentralization of work. The Board of Governors, for example, recently has passed on to the Reserve Banks some responsibilities in the field of bank supervision. More of this could be done. But a truly federal system requires that the sub-units contribute to the overall goal as a matter of right, not merely at the pleasure of the central unit. There is no real federalism unless "local management derives its power and function from structural necessity."<sup>21</sup>

Not only does increasing complexity of the economy and the financial system enhance the unique role of the regional Reserve Banks as administrative units of the System and as centers

of information, but it calls for continued participation of the Banks in the formulation of monetary policy. Because the Reserve Bank presidents serve on the Open Market Committee as a matter of statutory responsibility, they are much more effective than if they were to participate simply as advisers to the Board of Governors.

\* \* \* \* \*

As a prescription for a vigorous, long life, the foregoing propositions undoubtedly overlook many important ingredients; yet they are, I believe, the essential ones. Perhaps the most hopeful thing about them is that they require nothing radically new, but basically a continuation of what the Federal Reserve has been doing. The Fed *has* changed its values over the years. It *has* been developing an increasingly professional attitude toward its task. And it *does* follow a pluralistic approach in making decisions. What is needed is to be more prompt and sensitive in changing its values, to broaden and deepen its professionals' knowledge of the economic process, and to make even greater use of its federal structure.

All this, of course, is harder to do than it sounds. Many trade-offs must be made along the way. To become too professionalized runs a risk of losing touch with society's values. A decision-making apparatus that permits too-long deliberation over too many views cannot adapt promptly as these values change. But the path to the good life is strewn with hard choices. The Fed has made many wrong ones along the way, but if it can better its percentage of right ones, it can look forward to a long and useful existence.

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details of the social police; represses small disorders and petty misdemeanors; maintains society in a *status quo* alike secure from improvement and decline; and perpetuates a drowsy regularity in the conduct of affairs, which the heads of the administration are wont to call good order and public tranquillity; in short, it excels in prevention, but not in action. Its force deserts it, when society is to be profoundly moved, or accelerated in its course; and if once the co-operation of private citizens is necessary to the furtherance of its measures, the secret of its impotence is disclosed." *Democracy in America* (New York: The New American Library, 1956), p. 67.

<sup>21</sup> Peter F. Drucker, *The New Society* (New York: Harper & Brothers, 1949), p. 275.





## THE FED IN PRINT

### Current Sources on Business and Banking

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Most Federal Reserve Banks publish reviews which vary considerably in outlook and fields of interest. Some of them treat subjects of regional importance; others are directed to questions of a monetary and fiscal nature; still others discuss more general matters in the public and business areas. We in Philadelphia compile an index of these articles and produce a cumulative edition of it every two years. For an up-to-date look at current concerns of our researchers around the country, however, we are including in this issue of the *Business Review* certain topics from the year 1969 to provide an indication of the scope of the activity. In future issues we expect to cover the studies quarterly. This will enable us to incorporate all articles put out in the preceding quarter.

The Reviews themselves are available from the *individual issuing bank only*, upon request to the Publications Department of that Bank. Addresses of Federal Reserve Banks will be found on page 21.

DORIS ZIMMERMANN, Librarian

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Atlanta, Georgia 30303

Federal Reserve Bank of Boston  
30 Pearl Street  
Boston, Massachusetts 02106

Federal Reserve Bank of Chicago  
Box 834  
Chicago, Illinois 60690

Federal Reserve Bank of Cleveland  
P.O. Box 6387  
Cleveland, Ohio 44101

Federal Reserve Bank of Dallas  
Station K  
Dallas, Texas 75222

Federal Reserve Bank of Kansas City  
Federal Reserve P. O. Station  
Kansas City, Missouri 64106

Federal Reserve Bank of Minneapolis  
Minneapolis, Minnesota 55440

Federal Reserve Bank of New York  
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New York, New York 10045

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925 Chestnut Street  
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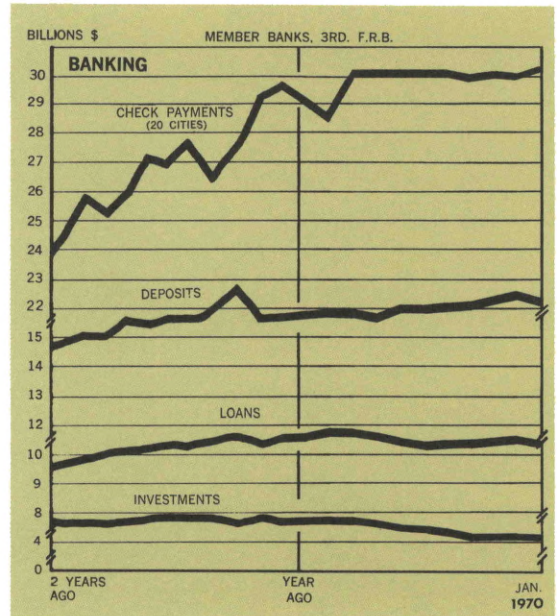
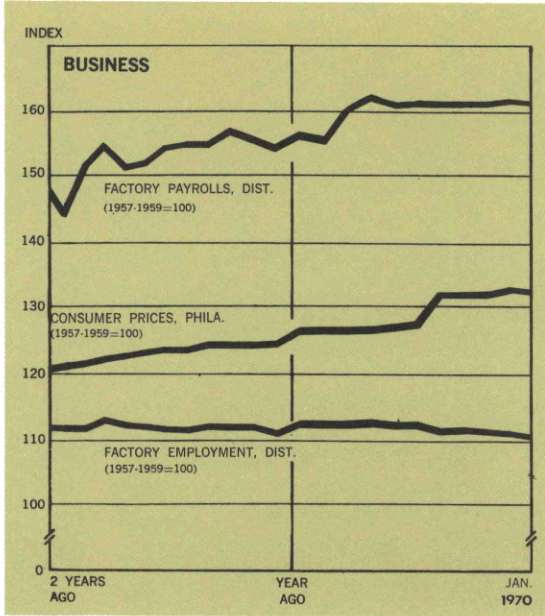
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# FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States			
	Per cent change			Per cent change			
	Jan. 1970 from		12 mos. 1969 from	Jan. 1970 from		12 mos. 1969 from	
	mo. ago	year ago		mo. ago	year ago	year ago	
<b>MANUFACTURING</b>							
Production .....	.....	.....	.....	- 2	0		
Electric power consumed	- 3	+ 5	.....	.....	.....		
Man-hours, total*	- 2	- 2	.....	.....	.....		
Employment, total	- 1	- 2	.....	.....	.....		
Wage income*	- 2	+ 4	.....	.....	.....		
CONSTRUCTION**	+26	+48	.....	- 6	+ 3		
COAL PRODUCTION	-14	- 8	.....	- 6	- 3		
<b>BANKING</b>							
(All member banks)							
Deposits .....	- 7	- 2	.....	- 7	- 2		
Loans .....	- 4	+ 8	.....	- 3	+ 8		
Investments .....	- 2	-10	.....	- 2	-10		
U.S. Govt. securities..	- 3	-18	.....	- 4	-18		
Other .....	0	- 4	.....	- 1	- 3		
Check payments***	+ 8†	+12†	.....	0	+ 9		
<b>PRICES</b>							
Wholesale .....	.....	.....	.....	+ 1	+ 5		
Consumer .....	+ 1‡	+ 6‡	.....	0	+ 6		

\*Production workers only  
 \*\*Value of contracts  
 \*\*\*Adjusted for seasonal variation

†15 SMSA's  
 ‡Philadelphia

LOCAL CHANGES Standard Metropolitan Statistical Areas*	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Per cent change Jan. 1970 from		Per cent change Jan. 1970 from		Per cent change Jan. 1970 from		Per cent change Jan. 1970 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Wilmington ..	- 1	+ 1	- 6	- 2	+ 3	+ 7	+12	- 4
Atlantic City..	.....	.....	.....	.....	0	+ 6	- 7	+ 3
Trenton .....	0	0	- 1	+ 4	- 5	+31	- 4	+ 8
Altoona .....	- 1	+ 3	0	+ 2	+ 2	+ 2	- 3	+ 5
Harrisburg ...	0	+ 2	- 3	+11	+ 8	+19	+30	+46
Johnstown ...	- 2	+ 4	- 2	+14	+ 2	+ 9	- 4	+ 9
Lancaster ...	- 1	+ 1	- 2	+10	+ 9	+22	-15	- 3
Lehigh Valley.	- 1	0	- 2	+ 9	+ 4	+ 4	- 2	- 7
Philadelphia .	- 1	- 3	- 2	+ 3	+10	+12	- 9	- 1
Reading .....	0	0	+ 1	+ 2	+12	+ 9	- 1	+ 3
Scranton ....	- 1	- 1	- 1	+ 3	+13	+ 2	- 2	+ 2
Wilkes-Barre .	- 1	+ 2	+ 1	+ 8	+10	+ 6	- 2	-21
York .....	- 2	+ 2	- 2	+10	-12	+11	-14	- 6

\*Not restricted to corporate limits of cities but covers areas of one or more counties.  
 \*\*All commercial banks. Adjusted for seasonal variation.  
 \*\*\*Member banks only. Last Wednesday of the month.