

RELEASE DATE:  
8:00 p.m.,  
Friday, June 15, 1962

L I V I N G   W I T H   U N C E R T A I N T Y

By Karl R. Bopp  
President, Federal Reserve Bank of Philadelphia

Fifth Annual Harold Stonier Memorial Address  
Before the Stonier Graduate School of Banking  
of the American Bankers Association  
Rutgers -- The State University, New Brunswick, N. J.  
Friday Evening, June 15, 1962

## L I V I N G   W I T H   U N C E R T A I N T Y

By Karl R. Bopp  
President, Federal Reserve Bank of Philadelphia

The rate of change in human affairs has accelerated so rapidly in recent years that many of us are becoming frightened. When one considers the possibility of nuclear annihilation, there is adequate cause for concern. Indeed the range of possibilities that opens before us, our children, and our grandchildren is so enormous that we are tempted to prefer security at a "reasonable" level of achievement to the possibility of far greater achievement coupled with the possibility of failure. Fortunately or unfortunately, we do not have such a choice.

I am sure that most of you have experienced occasions -- perhaps when your own future seemed particularly cloudy -- when you wished that life were more certain than it is. And, indeed, one purpose of education is to enable an individual to live more effectively with an unknown future. As A. Lawrence Lowell, former president of Harvard once said: "The mark of an educated man is the ability to make a reasoned guess on the basis of inadequate information."

It is tempting to conclude that the measure of a man's education is the accuracy of his reasoned guesses. And, of course, there is a kernel of truth in that idea, provided one is not enamored of percentages and allows for the quality and importance of the questions asked and the character as well as the number of "correct" answers. For example, a perfect record of correct answers for a lifetime would not merely be marred, it could be destroyed by a single wrong answer. Again, think of a single wrong answer that resulted in nuclear warfare after a lifetime of correct answers on many issues.

A man continues his education, formal and -- more important -- under self-guidance, to improve his powers of reasoning, his capacity to ask appropriate questions, his ability to ascertain and use relevant information. Nevertheless, the sanguine expectation that there may come a magic moment when one will have all the answers is a vain hope.

At first blush this thought may seem depressing. If, however, we try to visualize living with a future that would be certain, I am sure we will conclude that such a world would be intolerable. Suppose we knew in advance, with absolute certainty and in infinite detail, exactly what was going to happen. Does such a world sound attractive? Would absolute certainty give us what we really want?

Develop an answer by beginning casually with a favorite sport. Take fishing. Suppose you knew with certainty that you would not have a single strike all day. Now, I am told that a genuine fisherman is not interested in the fish he catches but in the sport of fishing. I am sure we will agree, however, that not being interested in the fish one catches and not catching any fish are not identical or interchangeable thoughts! And remember, you cannot change your mind about going because of the foreknowledge. That would introduce an element of uncertainty into life (as to whether you were going fishing or not); and what you have asked for is not fish but certainty!

Or take what would seem to be a happier prospect. Suppose you were certain that on your fifteenth cast, at seven thirty-two in the morning, a four-pound, small-mouth bass would strike and that, although you knew he barely had been hooked, you also knew that you would net him after he had twisted and dashed exactly as you knew he would for five minutes and thirty-two seconds. How much sport would remain in fishing if it merely confirmed what was known in detail in advance?

Doesn't the attractiveness of sports -- to say nothing of gambling -- suggest that uncertainty is an inherent and indispensable ingredient of daily living?

In more general terms, would life retain its meaning if it consisted merely of confirming what you and everybody else already knew? Wouldn't that be a living death? Wouldn't living with certainty be intolerable?

If, now, we start at the other extreme, it is equally clear that life also would be impossible if we knew nothing at all of the future. We could not live in a world in which any one event were as likely to happen as any other event. Life itself, as we know it, is possible only because there is an enormous amount of known regularity or system in the world. Just try to imagine what life might be like in a world of utter chaos!

As a start, visualize a world in which time were erratic. An important time magnitude in the world in which we live is the day which, for convenience, has long been divided into twenty-four hours. Suppose, instead, that each day had a different and unknown number of hours! It would be irrelevant to make an appointment for any given day, because there could be no way of assuring that it would be kept. And, of course, it would not help any to specify the appointment in terms of hours, because that would be based on the assumption that the length of the hour rather than that of the day is known. But complete uncertainty means that nothing of the future is known.

These brief illustrations may have convinced you that the world in which we live, difficult though it may be, is nevertheless preferable either to a world of caprice or to one of certainty. In any event, our problem is to live as significantly as possible in the actual world in which we find ourselves.

Rarely are our decisions of the black or white, of the either-or variety. Rather they are shades of grey. Life is permeated with paradoxes. War, for example, is the epitome of irrational destruction. Yet war and defense have brought forth unimagined creative forces in many fields: medicine, nuclear physics, electronics, aeronautics, and so on. We desire to achieve many goals, all laudable, but not

necessarily compatible, at least in the short run. Decisions frequently involve adjusting irreconcilables.

We must, of course, also take into account the fact that the universe is not static but developing. Obsolescence applies not only to material things, such as plant and equipment, but to ideas as well. Let me illustrate, again with a simple hypothetical example. Suppose that I had developed a formula whereby I could predict the price of Utopia Corporation stock accurately a week in advance. Suppose that I had confided my daily predictions for the past year to a notary public under seal. Suppose next that I were now to produce that notary public and ask him to compare my predictions with the actual prices of Utopia Corporation stock and that he proved them to be identical. Now, finally, let us suppose that I were to say: "Gentlemen, you have seen a demonstration of my competence. I stake my reputation on the prediction that the price of Utopia Corporation stock will remain at 52, where it closed today, until one week from today, Friday, June 22, 1962, when it will rise from 52 to close at 57." What do you think would happen? Obviously, nobody knows. Nevertheless, I have a strong hunch that, even though the prediction might have been accurate had I not made it public, it would no longer prove accurate, once it had been made public. Why? -- because some of you with money might believe me and not wait a week to acquire the stock!

This is but an elementary illustration of one way in which knowledge changes our behavior, thus changing the world in which we live, and thus in turn making the specific knowledge itself obsolete.

I hope I have said enough to indicate why I feel so strongly that we should approach our daily problems with an open mind. By this, I do not mean an empty mind that is always convinced by the latest argument it hears. Such a mind is not open but shallow and draughty. An open mind, rather, is one with convictions whose strength arises from the degree of intellectual compulsion of the

argument on which they are based and on the amount and depth of experience with which they have been tested. Some opinions should be only lightly held; others should be held with firm conviction. An open mind recognizes human fallibility and has a genuine willingness to expose all its opinions to new evidence and new argument and a correlative determination to change always and only as new evidence dictates.

Recognition of one's own fallibility implies a tolerance for the ideas of others. It is a mark of immaturity to harbor "the old conceit of being wiser than posterity -- wiser than those who will have had more experience," as Jeremy Bentham phrased it.

Perhaps I appreciate this advice more because I have spent a considerable part of my mature life as a teacher. Now a measure of success of the teacher is the quality of his students. Of course every individual must educate himself. No teacher can do it for him. A teacher does not indoctrinate but rather inspires the student to test his intellectual mettle against the teacher as a foil. A teacher is a real success when some of his students surpass him.

There is, of course, a limit to tolerance. Just as the tolerant man will not impose his ideas on others except through intellectual conviction, so he must resist efforts of the intolerant to impose their ideas on him by force.

Thomas Jefferson put it this way: "It behooves every man who values liberty of conscience for himself, to resist invasions of it in the case of others ..."

These considerations are relevant to an analysis of some of the proposals that have been advanced recently to simplify the Federal Reserve System to make it a more efficient agency of monetary policy.

Now, as president of a Federal Reserve Bank, I have more than a casual interest in what happens to the structure of the System. Obviously, therefore, I cannot be "objective." Nevertheless, a couple of decades as a teacher impressed

on me the pedagogical difficulties of describing and analyzing the complexities of the System as it has developed. An equal period as practitioner -- in part overlapping that of the pedagogue -- has given me some experience in the actual functioning of that System.

You should keep this background in mind as you judge for yourselves the merit of my views. I might say, incidentally, that perhaps both the System and I might have been better off had I been teacher when I was in fact practitioner -- and vice versa. At any rate, I recall that I was much more certain of what the System should do when I was a teacher and had no responsibility than I am now as practitioner. Or, perhaps, this means merely that it might be helpful all around if every teacher had a tour of duty as a responsible practitioner and each practitioner had a tour of duty as analyst without direct responsibility.

Since it is desirable to know what we have before we propose changes, it may be worth-while to describe the formulation of monetary policy in the System as it exists.

The organization of the System can be understood best in terms of our basic heritage. We as a people have felt deeply that centuries of experience demonstrate that concentration of power is extremely dangerous. We prefer a separation of governmental powers and a system of checks and balances with full appreciation that they may be, or appear to be, less efficient, especially in the short run.

What was desired in the Federal Reserve System was an organization that would not be controlled for partisan political purposes by the administration in power nor by private interests, especially the so-called financial interests. Congress solved this problem by making the System responsible to the Congress rather than to the President and by creating a rather complex organization in which government representatives would have final authority but private individuals would have an influence.

At the apex is the Board of Governors of the Federal Reserve System. It consists of seven members appointed by the President by and with the advice and consent of the Senate for fourteen-year terms. The long terms are designed to insulate the Board from the day-to-day pressures of partisan politics. In the unlikely event that private interests would attempt to seize control of the System, it is perfectly clear that the Board, selected by the Government, has the power to enforce its will. A united Board has authority over all the policy instruments, has power not only to exercise general supervision over the Reserve Banks but also to remove any officer or director of any Federal Reserve Bank, and may ignore the advice of the Federal Advisory Council. Within these limits, Congress felt that private interests could make a valuable contribution to monetary policy.

The Federal Reserve Banks are organized to blend public and private influences. Each of the twelve Federal Reserve Banks is supervised and controlled by a board of nine directors with three-year terms. There are three classes, each consisting of three directors. Class A are chosen by and are representative of the member banks. Class B are chosen by the member banks and are engaged in commerce, agriculture, or some other industrial pursuit and may not be bankers. To diffuse power it is also provided that member banks be grouped for purposes of electing directors into three groups: large, medium, and small. Each group of member banks elects one Class A and one Class B director. Finally, the Class C directors are appointed by the Board of Governors. The Board of Governors designates one Class C member as chairman and another as deputy chairman of the board of directors.

The general idea was that in establishing discount rates or the cost of credit, the board of directors should have the views of lenders (Class A) and of borrowers (Class B) with a public group (Class C) to resolve any differences that might develop.



I might say that my experience is that directors do not consider themselves as representative of any particular interest. I have known Class B directors to move an increase in the rate, even on occasion when the mover's firm had a security flotation in the offing. Similarly, Class A directors have made a motion to reduce the rate. Action on the rate is preceded by a review of economic developments presented typically by the vice president in charge of research. He, in turn, has consulted with his staff, which includes professionally trained economists and statisticians. The Federal Reserve Banks are the original source of significant economic data. Directors express their judgment on developments. A motion on the rate is made with reference to the total situation, not as a reflection of a narrow point of view. Ordinarily, though not invariably, of course, votes on the rate have been unanimous. I mention this so that you may have some feel of the spirit that motivates the directors.

The board of directors supervises the Federal Reserve Bank subject to the provisions of the Federal Reserve Act, including the power of the Board of Governors. They select the officers. Their selections of a president and a first vice president for five-year terms are subject to the approval of the Board of Governors. The president is the chief executive officer of the Bank.

The third agency in the structure of the System is the Federal Open Market Committee. It consists of the seven members of the Board of Governors and the presidents of five Federal Reserve Banks. The president of the Federal Reserve Bank of New York is a permanent member. The other four presidents are selected in rotation by the directors of the other eleven Banks which are divided for this purpose into four groups. All presidents attend and participate in the meetings, but only the members vote. Members and alternates take the oath of office upon assuming their statutory duties.

The Federal Open Market Committee usually meets every three weeks in Washington. Regional and national judgments are brought to bear on national monetary policy. Extensive and intensive preparation goes into these meetings. Principles of monetary policy as well as their application to current developments are analyzed. Professional economists at both the Board of Governors and the twelve Reserve Banks prepare analyses. In addition, each president has the views of his own directors. He does not go as an instructed delegate, however, but votes as his judgment dictates.

The whole gamut of monetary policy is discussed. The immediate result is a directive to the manager of the Open Market Account as to his operations until the next meeting.

The complexity of the System is illustrated when we relate the several instruments of policy to the agencies that have been described. The Board of Governors has exclusive control over the reserve requirements of member banks and over margin requirements for purchasing or carrying listed securities, the sole selective credit control instrument. Discount rates are established by the directors of the Reserve Banks subject to review and determination by the Board of Governors. The Board may determine rates for a Reserve Bank without initiation by the Bank. Open Market operations are determined by the Federal Open Market Committee. Since seven members are governors and only five are presidents; a united Board can determine these operations. In short, despite the complexity in detail, a united Board of Governors, as I have said before, has authority over all the instruments of policy.

The fourth agency is the Federal Advisory Council. It was designed to give the commercial banking community an opportunity to express its views directly to the Board of Governors. It consists of one banker from each Federal Reserve District elected annually by the board of directors. The Council meets quarterly with the Board of Governors. Members report to their boards after these meetings.

The fifth part of the System is the member banks. National banks are required to be members and qualified state chartered banks may become members. Member banks are required to subscribe 6 per cent of their capital and surplus to the stock of the Reserve Bank in their District. Half of this has been paid in and the other half is subject to call. The stock is unique in character. It does not convey residual ownership of assets, which revert to the United States in the event of liquidation. A cumulative 6 per cent dividend is paid. Each member may nominate and has one vote in the selection of the Class A and Class B Director for its group.

This capsule description of the System may serve as a basis against which to test proposed changes. The objective to keep in mind, of course, is the quality of monetary policy not the simplicity of structure or the sentiments of friendship.

One group of proposals would transfer to the Board of Governors all instruments of Federal Reserve policy. Some of those who have advanced these proposals are of the view that the presidencies of the Reserve Banks have attracted capable men, with recruitment from within more characteristic as the System has developed. They, therefore, propose that the Board be required to consult with the twelve Federal Reserve Bank presidents in establishing open market policies, the discount rate, and reserve requirements.

This conclusion would seem to be based on the assumption that the qualities of an individual develop in a vacuum, independent of the responsibilities of his position. I doubt that it requires actual experience as president of a Federal Reserve Bank to conclude that it does not make much sense to devote a lifetime to monetary policy only to end up as a statutory nuisance to his colleagues on the Federal Reserve Board. Incidentally, I wish I could claim credit for that phrase; anyone familiar with the history of the System knows I cannot.

Obviously, my views on the proposals are prejudiced. May I, therefore, say that they are in agreement with those of an experienced former colleague, whose motives have always been pure and can hardly be questioned now that he speaks from retirement. Allan Sproul, former president of the Federal Reserve Bank of New York, expressed his judgment to the Joint Economic Committee in these words:

I have said it (the Federal Open Market Committee) is the heart of the Federal Reserve System as it has evolved over the years, and it is. It is the forum where representatives of the constituent parts of the System -- the Reserve Board and the Reserve Banks -- meet as individuals and equals, bearing identical responsibilities under law to decide questions of high monetary policy. It is the group within the System which brings to the consideration of policy, knowledge of what is going on in government, in the money market, and in commerce, industry and agriculture throughout the country. Its members take back to the government, to the money market, and to the country, an understanding of what has been decided which is an essential ingredient of effective monetary policy.

I have said that if you remove the presidents of the Federal Reserve Banks from continuous (in the case of New York) or periodic (in the case of the others) participation in this high function you will tear down the spirit and morale of the twelve Banks, and I believe it. ... Participation in the work of the Federal Open Market Committee, with authority and responsibility -- the right to vote as well as to talk -- is what attracts the best men to the chief offices of the Federal Reserve Banks, and it is this contact which fills their official staffs with a sense of dedication and high purpose.

I move next to an analysis of legislation that has been proposed to change the terms of the chairman and members of the Board of Governors. Specifically, Bill S.3202 provides that the terms of office of the chairman and vice chairman be four years, beginning February 1, 1965 and that the terms of all governors be extended one year so that they will expire in odd-numbered years rather than even-numbered years, as at present. The purpose of these changes is to assure that there will be an opening on the Board and in the chairmanship shortly after a President takes office.

In analyzing these proposals, it is helpful to recount a bit of history.

The original Federal Reserve Board consisted of five appointed members with overlapping ten-year terms and two ex-officio members. The original Act specified: "Of the five persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board." Nothing was provided as to term. Until 1927 the designations were for one year, thereafter "until otherwise directed."

The Banking Act of 1935 replaced the Federal Reserve Board with the present Board of Governors consisting of seven members with overlapping fourteen-year terms. It provided: "Of the persons thus appointed, one shall be designated by the President as chairman and one as vice chairman of the Board, to serve as such for a term of four years."

Now, although four years is a time interval equal to the term of office of the President, it is not related to the calendar, as is the term of the President. The reason is that the four years begin when an individual is designated as chairman. For example, the term of the present chairman expires on April 1, 1963; because he began his service on April 2, 1951, and has been reappointed two times. Under the present arrangement a vacancy could occur shortly before the end of a President's term. The new chairman could then serve most of his term under the succeeding President. When I recall what I learned about "lame duck" officials when I was a student -- and the 20th Amendment to the Constitution -- I find it difficult to rationalize such an arrangement. It seems to me that in principle the terms of the President and of the chairman of the Board of Governors should be related in a systematic way rather than fortuitously.

As we move from principles to the immediate effects of application, it seems to me that the incumbent President would lose more than he would gain during the transition. First of all, extension of the terms of the governors by one year would mean he would have authority to designate one less governor: the one whose

term now expires on January 31, 1964. As to the chairmanship, the proposal is not yet law; the term of the present chairman expires in less than ten months, and the initial term of his successor will be shorter than if the law is not changed.

As to the larger question whether the proposed changes would make a political football of the Federal Reserve System, I agree with the judgment expressed by Chairman Martin:

My answer is there is nothing about the proposed change, in itself, that need bring any result other than a strengthening of the Federal Reserve's position as a defender of the integrity of the dollar. Whether some other result will in fact occur, I cannot in honesty purport to know. As I suggested at the outset, no one has ever been able to devise any absolute guarantee against political domination or politically motivated operation of the Federal Reserve, or for that matter of any of our institutions. In my judgment, we always, as now, will have to rely for that purpose on the character and devotion to duty of those to whom the final responsibility for the conduct of our institutions is given.

Whether the System is to be changed: fundamentally, into what in effect would be a central bank with branches; or technically, to make systematic what is now fortuitous; or not at all -- these are among the uncertainties that face us. The outcome is important not only for those in the System but for the monetary policy and economic development of the country.

How does one live with such uncertainties? First of all by recognizing that security like happiness always eludes those who pursue it directly. Second, by not running scared but by focusing attention on the task of developing the best monetary policy of which one is capable. Finally, by having faith in the considered decisions of an informed public.

After all an organization has no inherent right to continue merely because it is created by statute. The law can be changed; and it should be changed if the institution works badly. In the final analysis, the future of the System will depend, as it should, on the quality of its performance -- as judged not by those in the

System but by the electorate. Fear of the future vanishes not when one pursues an illusory security but when he responds to a worthy challenge of public service.

# # # # #