

THE HUMAN SIDE OF THE FEDERAL RESERVE --
OBSERVATIONS IN RETROSPECT

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Observation in Retrospect**

The Appeal of Black Capitalism

✓ The Human Side of the Federal Reserve—Observations in Retrospect
... *Although the Federal Reserve deals with numbers and economic forces, human values are of ultimate concern.*

The Appeal of Black Capitalism
... *A new approach to the economic problems of Negroes offers some hope, but faces certain economic stumbling blocks.*

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The Human Side of The Federal Reserve — Observations in Retrospect*

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Twenty-eight years ago I reversed Horace Greeley's advice and moved *East* from the University of Missouri to the Federal Reserve Bank of Philadelphia. This is the twelfth time I have sat here at the head table and the last time I shall address you in my present capacity. I should like, therefore, to use this opportunity to make some long-run observations about the Federal Reserve System.

Much has happened during my Federal Reserve career. We have been in three wars; we have been served by six Presidents. We have seen fantastic accomplishments in the sciences and in the arts. Among the most exciting have been the astronauts' ventures into space. In reading about reactions of the men who circled the moon some five months ago, I have been impressed by the perspective of the earth that one gets from a quarter of a million miles away. Viewed from that distance, geographical barriers vanish, international divisions fade away. Removed from daily chores, one gets a different perspective of life. Today, as we look together at the Federal Reserve, I shall take an "astronaut's" view.

As I do this, I am struck by how many issues fall away into insignificance. What is left, what stands out as the only thing worthwhile, is people—human beings.

This observation may appear rather obvious, but it is one we tend to forget as we go about our day-to-day activities and face our momentary troubles. When all is said and done, perhaps the greatest advance in my time—greater than all the scientific achievements—has been the increasing affirmation of human values. This is what gives me greatest satisfaction in surveying the past and most hope in assaying the future.

Today, therefore, I should like to center my remarks on some human aspects of the Federal Reserve—the "people side" of the Fed. In par-

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titular, I shall look at (1) monetary policy, (2) decision-making in the Federal Reserve, and (3) relationships between the Federal Reserve and commercial banks.

MONETARY POLICY

As you know, the Federal Reserve System, as the nation's central bank, has a manifold task, concerning itself with full employment, price stability, and the balance of payments. From any perspective, this is a most formidable task. It is formidable, for one reason, because the economy consists of over 200 million individuals making their own economic decisions and subject to quickly changing mass psychology.

The difficulty of the Fed's task is compounded by the apparent conflicts, at least in the short run, among its objectives. We must help keep the economy as fully employed as possible without risking runaway conditions which could lead to inflation and, ultimately, depression. We must attempt to achieve favorable conditions on both the domestic and international fronts. We must try to maintain an economic environment in which all people who are willing, able, and seeking work can find jobs, but at the same time maintain the real income of those in retirement.

Often the Fed has to trade-off one objective against another. For example, we may have to be content with less than maximum immediate growth of our domestic economy in order to keep our balance of payments from deteriorating to the point that we cannot play a leading role in the world economy. We may have to accept some inflation to achieve full employment—or some unemployment to contain inflation.

In all these possible trade-offs, human values are uppermost. The damage which inflation can inflict on the growing number of people living on fixed incomes has to be measured against the damage which unemployment can bring to another large sector of our population. It is not

just numbers—not just price indices or unemployment rates—that must be minimized or maximized. It is the quality of human life that is of paramount concern. I know the pain of unemployment. During the depression of 1921, my father, who was a carpenter, found himself out of work. The pain of unemployment is not just economic—it is emotional and psychological as well. For the disadvantaged the cost in terms of human achievements foregone is borne by generations.

Although these costs always have existed, they have come to the forefront of public policy in the past twenty-five years. The searing effect of the Great Depression survived the prosperity of World War II and found its expression in the Employment Act of 1946. That piece of legislation is perhaps the most important single affirmation in our lifetime of the concern of this nation for the plight of the economically disadvantaged. It helps to explain much of what has happened since. It helps to explain, for example, why this country, after World War II, and unlike its experience after every other major war in its history, did not suffer a sharp recession. It helps explain why prices did not decline sharply as they had after the Revolutionary, the Civil, and the First World War.

Elevation of human values to a position of top priority, in short, has produced an economy that is more humane. But it has immensely complicated the task of those who are responsible for guiding that economy. It is no longer acceptable to take the view, once prevalent, that depressions are necessary periodically to purge the economy of its "excesses." The difficulty the Federal Reserve faces today in restraining inflation stems partly from its concern for social justice. With 22 per cent of nonwhite teenagers out of work even now when the economy is going at full steam, it is clear who would be first to feel a recession. Yet the costs of continuing inflation, though somewhat less appar-

ent, hit hardest our older citizens who also are ill equipped to meet those costs.

As these human costs have come to the fore, society has greatly narrowed the margin of error it permits its officials, including the Federal Reserve. We now work within much closer tolerances than even ten years ago. Thus, even though the economy has been performing better, on average, than ever before, we have been criticized—understandably—for overdoing restraint in 1966 and for excessive ease in 1968.

Let me make myself clear. I am not concluding that the Federal Reserve—or anyone else—has tamed the business cycle. I remember too well the widespread complacency of the late 1920's. But I do believe that increasing emphasis on human values has greatly changed the size of the stakes. The public is not willing to tolerate gross errors of the 1929-1933 variety. Federal Reserve and other public officials must perform—or else. This raises the question of the kind of people making decisions in the Federal Reserve and how they go about making them—my second point.

DECISION-MAKING IN THE FEDERAL RESERVE

Decisions are made in the Federal Reserve in an atmosphere of less than perfect information. Over the years we have collected vast amounts of statistics and have learned a great deal about how our economy functions, how financial markets function, and how the impact of monetary policy is transmitted through financial institutions and markets to people who make spending decisions. But the more we learn, the more it is apparent that there is still much more to learn about this exceedingly complex economy. A multitude of factors affects our economic environment. These factors, as well as the relationships among them, are changing constantly. So, pushing out the frontiers of knowledge is an essential, but difficult, task.

The longer I participate in policy-making, the

more I am convinced that pat formulas for reaching decisions do not exist. The tasks of policy-makers would be easier if some magic formula were available. But the ever-changing nature of the variables with which the Fed is concerned precludes a simplistic approach to decision-making. We must rely upon judgment—judgment solidly grounded in theory but sensitive to new developments and to new priorities.

In making these judgments, the Federal Reserve System relies heavily on a pluralistic decision-making process. We are convinced that all truth does not reside in one place or in one man. Judgments are based on a free interplay of ideas flowing from the member banks, the boards of directors and staffs at the Reserve Banks, and the Board of Governors in Washington. I have seen this work; and it works well—not perfectly, but well. One advantage of the process, of course, is that it adds stability. Ideas are cross-checked, balanced against other ideas, and compromised. The chances of the Fed going off half-cocked are remote.

I am increasingly impressed, however, by another advantage of this approach, and this is one that is less often recognized. John Gardner has touched on it. He 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." With the Federal Reserve under such great pressure to perform in this fast-paced economy, it stands much more chance of coming up with a break-through idea under this arrangement than under one in which all authority is centralized.

This is the great strength of the System's structure. I have attended some 179 meetings of the Federal Open Market Committee—meetings in which seven Governors and twelve Presidents and perhaps half a dozen staff members

have something to say. Although the spirit of innovation has not been present at every one of these meetings, I have seen it often enough to be convinced of the value of this kind of group participation.

In the course of perhaps 288 meetings of the board of directors of the Federal Reserve Bank of Philadelphia, I have seen this spirit often enough to be convinced that the Reserve Banks and the System as a whole are much better run because of this kind of decision-making.

And, finally, I have seen the same dynamism at work within the staff of the Federal Reserve Bank of Philadelphia. I am sure the same high-quality results would not have been forthcoming had I been making all the decisions—even if it had been physically possible for me to do so.

The process can work, the structure can hold together, however, only so long as we can attract and hold top-notch men. And we can do this only so long as we can offer them opportunities to contribute.

RELATIONS WITH COMMERCIAL BANKS

After much trial and error, I have concluded that one of the essential ingredients for getting along with my fellow man is a mutual understanding of and respect for motivations. This is no less true for institutions.

Recently, Professor Richard A. Falk, Milbank, Professor of International Law at Princeton University, noted that "John Maynard Keynes long ago spoke of the paradox of aggregation—that the definition of rational self-interest is different for the individual than for the community. If one's car is polluting the atmosphere, the addition to the general pollution is so infinitesimal that there is no rational incentive to forebear from driving, or to spend money on anti-pollution filters." This paradox helps to explain the relationship between the Federal Reserve and commercial banks.

Commercial banks exist primarily to make

money. True, you want to serve your communities and protect your depositors, but these are subsidiary motivations. The Federal Reserve, on the other hand, exists primarily to further the public welfare. And although it is not motivated by a desire to keep you from making money, it must at times, and in different ways, frustrate your plans and desires. It does this in carrying out its responsibility for monetary policy and frequently as a banking supervisor.

We have in this situation the makings of a first-class confrontation. But this will not result in violence if we understand and respect each other's motivations. Let me give two examples.

The first stems from the ingenuity of the human mind in devising ways to get around controls. Bankers may not always have exhibited this characteristic, but they are now making up for lost time.

Bankers today are an innovative breed. They dream up new services, new approaches to the provision of old services, and the means of satisfying a greater array of the public needs. I am making no moral judgment when I point out that bankers devote considerable resources to devising means of circumventing restrictions on these activities. Recently, a number of ingenious devices have appeared. These devices have enabled banks to secure funds in a time of restrictive monetary policy and despite a ceiling on interest rates on time deposits. Some banks have grouped portions of their loan portfolios and have sold participations in these pools of loans. We have seen one-bank holding companies secure funds through the sale of commercial paper and then channel these funds to the subsidiary commercial bank. We have seen banks attach letters of credit to obligations of their prime customers so that these obligations may be sold in the market.

As bankers have devoted many hours in devising ways of circumventing regulations, monetary and banking authorities have had to devote

their energies to considering how to respond. So, we have a cumulative effect in the costs involved in circumventing the restrictive provisions of banking laws and regulations.

I repeat, there is nothing morally reprehensible in all this. But it can be wasteful. My preference, as a matter of principle, is to rely as much as possible on market forces to discipline bank behavior. The Federal Reserve has plenty of power to safeguard the public interest without building a cumulative structure of detailed regulations to close each newly discovered loophole. And in a free market banks can devote their energies more productively to meeting and beating their competition in serving their communities.

Nevertheless, so long as the Federal Reserve is responsible for the public welfare and commercial banks are responsible for making money, the game will go on. So long, however, as commercial banks respect what the Federal Reserve is trying to do and the Fed respects what the banks are trying to do there need be no insoluble problems.

My second example has to do with membership. I am happy to say that this has not been a major issue so far as New Jersey banks are concerned. It *has*, however, been elsewhere, and I feel it is so important that I should like to take this opportunity to make a few observations.

Having studied central banking all of my adult years and having practiced it for many of them, I am convinced of the importance of the job the Federal Reserve is doing. I know, of course, that there are many different ways to go about the job and many different ways in which a central bank may be organized. In the case of this country—for many reasons, historical and other—commercial banks are linked to the central bank by membership and by reserve requirements.

These are a means by which the banks—as private, profit-making institutions—share the burden of the public function which the banking

system performs. From my present vantage point, I am convinced that this burden must be shared more equitably if the Federal Reserve is to continue to do its job effectively.

Commercial banks are private, profit-oriented businesses. As such, they have an incentive to leave the System if this will increase profits and give them a competitive edge. But they are also the principal intermediary for the transmission of monetary policy. Therefore, it should be clearly understood that what may be acceptable behavior for one bank or a few banks may be unacceptable for the banking system. Banking is not like other industries and it is worse than useless to pretend that it is. And while I can understand why individual banks find it in their best interests to leave the System, it is more difficult for me to understand why some state banking laws provide incentives for such exits to occur. Should withdrawals proceed to the point where they seriously weaken the ability of the Federal Reserve to carry out its responsibilities as a central bank, the Federal Government will be forced to act. Meanwhile, states still have an opportunity to assume their share of the responsibility for devising a banking system conducive to effective monetary policy.

CONCLUSION

Having looked back over the past, what can I now say about the future? I have limited confidence in my ability as a forecaster. Thus, had I attempted, twenty-eight years ago, to specify what the world would be like today, I would have missed by a wide mark indeed. Events have moved much faster than I would have dreamed. And so there is little I care to say about where events will have taken us twenty-eight years from now.

But on the main subject of today—people—I feel more confident in forecasting. History demonstrates that the individual has become more important. And although I would hesitate

to project a straight-line trend into the future, I believe that human values will be given even more attention than they are now.

This message may seem out of place in today's environment of self-guilt, bitterness, and recrimination. This environment, I believe, is itself a reflection of greater concern for people; painful as it is now, we will emerge the better for it.

If I am right about this, the objectives of the Federal Reserve, its decisions, and its relations with others—including commercial banks—will also increasingly recognize the human component. The Fed, as a public institution, must, after all, *reflect* the society which it serves. I also hope it can at times continue to *lead* it.
