Federal Reserve Board Oral History Project

Interview with

William W. Sherrill

Former Member, Board of Governors of the Federal Reserve System

Date: March 29, 2010

Location: Houston, Texas

Interviewer: David H. Small

Federal Reserve Board Oral History Project

In connection with the centennial anniversary of the Federal Reserve in 2013, the Board undertook an oral history project to collect personal recollections of a range of former Governors and senior staff members, including their background and education before working at the Board; important economic, monetary policy, and regulatory developments during their careers; and impressions of the institution's culture.

Following the interview, each participant was given the opportunity to edit and revise the transcript. In some cases, the Board staff also removed confidential FOMC and Board material in accordance with records retention and disposition schedules covering FOMC and Board records that were approved by the National Archives and Records Administration.

Note that the views of the participants and interviewers are their own and are not in any way approved or endorsed by the Board of Governors of the Federal Reserve System. Because the conversations are based on personal recollections, they may include misstatements and errors.

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MR. SMALL. Today is Monday, March 29, 2010. I am David H. Small from the FOMC (Federal Open Market Committee) Secretariat in the Division of Monetary Affairs. I'm at the Houston Branch of the Federal Reserve Bank of Dallas interviewing William W. Sherrill, a former Board Governor from May 1, 1967, to November 15, 1971. During most of his term, he was the Board's Administrative Governor. Thank you for being here, Governor Sherrill.

Personal, Educational, and Professional Background

MR. SMALL. Let's start with your personal history—your early education and formative experiences—leading to you coming to the Board.

MR. SHERRILL. I was born here in Houston, Texas, in 1926. My father was a Morse code department supervisor for Western Union, which was a large and booming department at the time, and he was an up-and-coming young man. In 1927, we moved from the east end into the west end of Houston, which was growing and becoming prosperous. Unhappily, in 1929, the Depression came along, and things went from being positive and growing to a very bad situation economically.

My dad kept his job through the Depression, but his pay kept getting smaller. We had relatives move in with us because many of them lost their jobs. The experience of living through the Depression was not quite as bad for my family as for some others, but we felt the impact of the Depression.

Of course, as a youngster you don't really know it's any different than it's supposed to be. As far as I was concerned, the only effect that I had from the Depression was the schooling. In the schools, I had hand-me-down clothing, so my clothing was a little shabby around the edges and not quite up to par with the other children in the school, which made me not enthusiastic about attending.

I finally wound up in the eighth grade in Lanier junior high school. I was failing more than I was passing, which was hardly a surprise because I was absent more than I was present. I had a really bad attitude about schooling.

Then World War II came along. Pearl Harbor was attacked on December 7, 1941, and I entered the Marine Corps on December 26, 1941. I was 15, but I registered as 17. At that time, there was so much fear of an invasion of the United States that there weren't a lot of questions asked if you were able to serve and you knew how to use a rifle and other weapons. Being Texas-born, I had rifles and pistols training.

I was accepted into the Marine Corps. I went through boot camp in San Diego in a rush, and, in March 1942, I went to Pearl Harbor and then down to Palmyra Island. Palmyra was one of four outpost islands we had left after we lost Wake Island. The First Defense Battalion had airfields at each one of those islands to defend Pearl Harbor. Palmyra was almost directly south—about 1,000 miles south of Pearl Harbor—and was never attacked. The others were Johnston Island, which also was not attacked, and Midway. People are aware of the great Battle of Midway and the Battle of Wake Island that we lost at the beginning of the war. The four detachments of the First Defense Battalion were Wake, Midway, Johnson, and Palmyra.

I was in a group of reinforcements that went down to Palmyra—there were only eight of us. The Marine Detachment on Palmyra Island was all pre-war, professional, well-trained Marines. They understood the Marine Corps thoroughly—weapons, combat, and other things. I was on Palmyra for 16 months. I developed physically and got the type of training I doubt I could have gotten any other way. So by the time I was ready to enter the main aspect of the war, I was already prepared. I went from Palmyra back to the States for six months. Then I went over the second time and joined the Third Division, 9th Marine Regiment, for the Bougainville

Campaign. After Bougainville, we based on Guadalcanal. Our next action was the Guam Campaign. We based on Guam for the Iwo Jima campaign.

I had expected to make the Marine Corps my profession. I had signed up as a regular for four years and was going to be a professional Marine. But I was shot on Iwo Jima. I was hit in a nerve in my left arm. I spent 14 months in the Oakland Naval Hospital. I was medically then discharged and unable to continue as a Marine professional.

When it was announced that I was going to be medically discharged, I was in dismay and depression. At the time, things looked bad to me, but it turned out to be the greatest thing that ever happened. I got a chance to take the GED tests—General Educational Development tests—in the hospital. When I got out of the hospital, I entered the University of Houston.

MR. SMALL. In the war, were you on those landing crafts where the front would come down and you charged the beach?

MR. SHERRILL. We used the Higgins boats at Bougainville and at Iwo Jima. I was in the first wave on Guam; we used the Alligators there. We were supplied by the Higgins boats that brought reinforcements in. The Alligators were tracked vehicles—essentially the same idea as the Higgins boats—but they are able to go up on the beach rather than having to stop at the water line, so you'd get a little advantage.

MR. SMALL. You'd get protection further up before the door drops?

MR. SHERRILL. In those days, the Alligators didn't have the door drop. You'd have to go off over the side, which was quite a drop. You had the disadvantage of having to get up into the air then drop 10 feet onto the ground, but you usually got past the water line. In our case, we didn't at Guam, because there was a sea wall. The first man that went over the front of the vehicle was an artillery captain who was in our craft. When he jumped down, he landed on an anti-vehicle mine and blew the entire front end of the vehicle in. It killed the driver and the assistant driver, but we were protected in the rear by the entire front of the craft, so the only loss we had was the captain and the two drivers at the beach line. Guam was our second campaign.

You learned to get off of the beach. The real danger was on the beach. If you get behind the beach defenses before they are remanned—they've been subject to a great deal of artillery and naval gunfire, so they tend to be in shock at first—if you can get past the beach defenses with the first wave, then you prevent any enemy reinforcements getting to the beach while the second wave comes in and takes care of the beach defenses. It was a system that worked very well at Guam.

MR. SMALL. So your mental framework changed a lot between high school and the end of your participation in the war?

MR. SHERRILL. It changed remarkably.

MR. SMALL. You had two segments: the training first, in relatively noncombat situations, then the combat. Do you think one was more important than the other for changing your experience?

MR. SHERRILL. Well, they're linked. Your chances of survival in combat increase because of the training. When you go into combat, you go into automatic gear once you're really under fire. If you're trained, your training kicks in and you instinctively do the right things. I observed some of the greener troops that didn't get adequate training. Their casualty rate was higher because they did not have the right reaction at the right time.

MR. SMALL. Did you carry that perspective from the Marine Corps into schooling—that training is good, and you better take training more seriously?

MR. SHERRILL. Well, I didn't link it that way. In fact, I didn't realize until later that the mental discipline that training brings is a valuable tool. I carried that mental discipline from the Marine Corps into my education. I seriously applied myself this time because I saw the difference between education and no education, the difference between being a commissioned officer or being a noncommissioned officer, and it was principally education that made that separation. I realized that I would rather have been a commissioned officer, so I went back to school with a keen desire to succeed.

I went to the University of Houston and did well there. Then another one of those lucky breaks in life occurred. One of my professors that I had throughout the four years at Houston University kept me after class to meet a speaker we had from the Harvard Business School. When class was over and we were introduced, he asked the fellow to get me into the Harvard Business School. [Laughter] I'll never forget it. My mouth fell open because I never considered graduate school. And the man's mouth fell open because he was caught by surprise. He said, "Well, John, it's not just hard to get into Harvard, it's hard to get through." [Laughter] And Mr. Wilkins said, "Well, Paul, I've never recommended another young man to you, but I'm recommending this one." Paul helped me get in.

I got my master's degree at the Harvard Business School. It was a life changer. In addition to the education itself, there's a label. Through life, now, I realize that labels are important—labels get you in the door. You have to have the content once you get in the door, but many times you don't get in a door without the label. So it's wise to be aware that labels have a value and not consider them superficial things.

MR. SMALL. Then you went back to Houston?

MR. SHERRILL. I went back to Houston, working for the telephone company, as I had while I was going to undergraduate college. After returning from graduate school, I got involved in a civil defense drill. The head of civil defense at that time was R.E. “Bob” Smith, a wealthy Houston oilman. I was enlisted to do the sabotage squad, and I was very effective. I blew up (interrupted) a lot of things here in Houston and confused the drill considerably. I thought that Smith would be angry with me, but instead he hired me to come down to City Hall and run civil defense. That’s how I got involved in government the first time.

MR. SMALL. Was this in the context of the war?

MR. SHERRILL. This was right after the war, when people were very war conscious. We had the atomic bomb, and there were bomb shelters in those days. Civil defense was very important.

MR. SMALL. You were the city treasurer?

MR. SHERRILL. That was in another administration. Roy Hofheinz, who built the Astrodome here in Houston, was mayor from 1953 [to] 1955. Under his administration, I was the administrative officer of civil defense. Then I was moved to head the traffic courts department. I left City Hall when Hofheinz left, and I was out of government for two years.

For a year or so I went into business for myself for the first time after spending some time on Hofheinz’s staff. I managed to lose my entire savings of $20,000 in my first business attempt! But I learned a valuable lesson: You should never have a single source of supply. My supply was cut off, and my business was lost.

MR. SMALL. What was the business?

MR. SHERRILL. The business was importing a bamboo Otatea out of Mexico for decorative fencing. The permits were cut off in Mexico. I had not arranged a second source, and I was out of business.

MR. SMALL. And you got to know Jack Valenti?

MR. SHERRILL. Yes, Jack Valenti was at the University of Houston. After I had lost my money and my business, I went into business with Jack, Welcome Wilson, Johnny Goyen, and Welcome's brother, Jack Wilson. It was real estate development. Then we were backed by R.E. "Bob" Smith; he was our mentor, he cosigned our notes and made us acceptable at banks. We formed the Jamaica Corporation, a land development company, and developed Jamaica Beach on Galveston Island. We were succeeding at that and doing nicely when Lewis C. Cutrer was elected mayor of Houston [1957–63], with Mr. Smith's backing. Mr. Smith was a reformer; he would back reform candidates. At first I was offered a job to head a department, but I declined because I was doing well at business at last. Mayor Cutrer had developed administrative troubles after he was in office for about nine months. Mr. Smith—who called everybody "partner"—called me and said, "Hey, partner, our friend Lewis is having a little trouble down at City Hall." I said, "Yes, sir, I've kept up with it." He said, "I expect he could use a little help down there." I said, "Yes, sir, I expect he could." He said, "I told him you'd be glad to come down and help him." I said, "Yes sir, I will." [Laughter]

That's how I got back in City Hall the second time. I went in first as an executive assistant to the mayor to analyze the problem and figure out why everything was slowing down in the city. Then I became the chief administrative officer of the city. Three years later, when I was getting ready to leave City Hall, the mayor asked me to stay as city treasurer to get the budget set. I told him that I had already made arrangements to leave, and the budget took five or six months. He said, "We'll do it in one month this year." I said, "Mayor, it's never been done in a month." He said, "Well, I'm going to concentrate on it. We'll get it done in a month." The day I was sworn in as City Treasurer, he came to me and announced that he was going to do the Lake Livingston Water Project, which was a huge project with big bond issues and that sort of thing. Needless to say, it was six months before we got the budget set.

Then I went back to Jamaica Corporation. We were doing real estate development, and we expanded into several other things. We did a savings and loan and a small bank. That's how I got into finance, in the banking sense. While I was at the telephone company, I was president of the federal credit union. I had some diverse experience in finance at that stage.

MR. SMALL. Then you were president of Homestead Bank?

MR. SHERRILL. Right. That was in that same period. After I left the savings and loan, we chartered Homestead Bank, a small, neighborhood bank. I was charter president.

MR. SMALL. That business would have been customer loans, business loans?

MR. SHERRILL. Yes, it was a small, community service bank.

MR. SMALL. So you were evaluating individual credits?

MR. SHERRILL. I learned by watching how the loan officers worked it, how they appraised credit. In those days, there were no machines. There was no credit scoring. You would interview an applicant and appraise his record based on what you had available. What really got a loan approved by a loan officer and the loan committee was when a loan officer would say to the committee, "This man does what he says he'll do." That would get the loan approved every time. It was a different world of credit approval in those days than you find now.

MR. SMALL. You kept the loans on your balance sheet.

MR. SHERRILL. That's right. We weren't into participations. There wasn't any real leveraging. It was a much simpler type of banking than you find now. The idea of making a loan that you didn't expect to collect was never done, because the loan officer wasn't loaning you his money, he was loaning you his career. If you messed up on your loans as a loan officer, your career was short, indeed.

MR. SMALL. What was your regulatory agency?

MR. SHERRILL. We were a state-chartered bank, so the FDIC was our regulator, as well as the state.

MR. SMALL. And bank examiners would come in every so often?

MR. SHERRILL. State bank examiners would come in. The FDIC would come in, if it wanted to, but mainly the state banking examiners examined us.

MR. SMALL. The examiners could go through your books at any level of detail, individual loans?

MR. SHERRILL. They went completely through the books. Initially, because we were a newer bank, they did a very thorough job. Once they found out we had reasonable judgment, from that point forward they did a more normal examination.

Government Service in Washington

MR. SMALL. In 1966 you went to the FDIC. How did that happen?

MR. SHERRILL. I was coming home from a ski trip in Aspen. In those days, you changed planes in Denver to get to Houston. I'd gotten on the plane in Denver for Houston. The plane was held up, and I was called off the plane and told that the White House was calling.

At the time, Lyndon Johnson was President and Jack Valenti was one of his assistants. I'd already explained to Jack that I was prospering at last. I'd done what I needed to do for government service, and I didn't want to be appointed to a position in Washington. It wasn't Jack calling and it wasn't the President—it was another assistant that said, "Come straight to the White House, the President wants to talk to you." I said, "I can't. I've got on ski clothes." He said, "Well, call Houston, have someone pack a bag for you, change planes, and come as quick as you can." This call was around Friday at noon. I arrived in Washington about 9:00 Friday night. A room was reserved for me in the Hay Adams near the White House, and I was told to be ready first thing in the morning. Being a former Marine, I was up early, at 5:00.

MR. SMALL. You weren't sure what you were to be ready for.

MR. SHERRILL. I had no idea. I couldn't get a call in to Valenti—he wouldn't answer the phone. My wife was calling from Houston saying, "The reporters know that you're in Washington. They don't know why, and they're asking me. I've told them I don't know. One of the reporters that we know thinks I'm not telling him the truth, because surely I know!"

I arrived at the White House about 11:30. I was taken to what was called the "Fish Room," where all the reporters were. I still didn't know what was going on. They were all rushing around. At about 11:45, a staff assistant handed me a single sheet of paper. It was my nomination as director of the FDIC. I had had no contact with the President. That's the first time that I knew what the directive to come to Washington was all about.

I prepared a speech gratefully declining. At noon, I was taken to the Oval Office. The President was behind his desk, and there were about 40 people in the room. They were a touring group of editors. The President was announcing my appointment, and I was standing at the door behind all these people.

MR. SMALL. Did he have an idea that you would likely decline?

MR. SHERRILL. He never gave that a thought. Johnson didn't think that way. After the group left, he took me into a side private office beside the main Oval Office. I have a great picture of me sitting on a footstool with my hands on my knees. Johnson was sitting in a big chair leaning down talking to me. I look like a little puppy! He tells me how wonderful it is that the nation has men like me willing to sacrifice and help do the hardest job in the world—the presidency of the United States.

When he finished, my speech was trickling down my throat. [Laughter] Later, one of my friends asked, "What would he have done if you had said you were not going to do it?" I said, "Well, he mentioned Vietnam!" [Laughter]

So I now know I'm nominated, but I don't know what that means. Nobody briefed me. I went to the Secretary of the Treasury, Henry Fowler [1965–68]. It was late Saturday afternoon. Fowler was a wonderful southern gentleman. I said, "Mr. Secretary, I don't know what I'm going to do. I've got all these loans out. I can't be a bank regulator. I'm involved in borrowing from multiple banks, and I have partnerships and what have you." He just laughed and said, "Bill, you're not the first guy in this position. Who's your attorney? He'll handle it. Call him and tell him what the situation is and get him started. You'll have to put some of your assets in a blind trust. You'll have to sell some things. Let him handle all of that for you."

I flew back home to Houston on Saturday evening. On Sunday, there was an all-day legal conference with lawyers coming and going. In the afternoon, they were coming in wearing tuxedos because they had other things to do. My assets were auctioned and sold or placed in a blind trust.

MR. SMALL. There was a legal conference of your lawyers trying to sort through everything?

MR. SHERRILL. There were also lawyers for people who were buying assets or who were going to be trustees. It was a great big scramble that went on until late Sunday evening. Then, on Monday morning, I flew back to Washington.

MR. SMALL. So between Friday, when you were returning home from a ski trip, and Monday morning, when you returned to Washington, all of this occurred?

MR. SHERRILL. Yes. I arrived back in Washington on Monday morning. Remember, I've only been nominated. I have to go through Senate confirmation. I went to the FDIC. I met the chairman, Kenneth A. Randall. He clearly had a lot on his mind, but he was very gracious. Then I had to be confirmed. The White House staff gave me an escort to go around and meet the senators on the Senate Banking and Currency Committee. You meet them individually and privately. They can ask you any question they want, and you must answer honestly or not answer. They get to decide ahead of time how they're going to handle you when you come up publicly in the actual hearing itself. I spent a day going from Senate office to Senate office trying to convince senators that I was a nice man. I'm trying to find some common ground—I was a Rotarian with one, a Marine with one, a Harvard Business School graduate with another. I always found some common ground.

The next day, when the actual hearing took place, the treatment was very kind. It wasn't at all like the hearings now. The questions were soft, so it went nicely. In those days, Republicans and Democrats were getting along. The Senate confirmed me as the new director of the FDIC one week from the time that I heard about my appointment.

The FDIC had a three-man board: the chairman, Kenneth Randall; the Comptroller of the Currency, James "Jimmy" Saxon; and the director, but that position had been vacant for eight months.

During the eight months, San Francisco National Bank had failed. San Francisco National Bank had what were called "brokered deposits." Brokers had collected $10,000 deposits from a number of people, put them together in a $100,000 deposit, and put it in the San Francisco National Bank as a brokered deposit.

MR. SMALL. Those would have been FDIC insured?

MR. SHERRILL. At the time, the limit for insured deposits was $10,000, so only $10,000 of the $100,000 was insured. That was the problem. Kenneth Randall said, "It is one deposit, $10,000."

MR. SMALL. Not 10 deposits?

MR. SHERRILL. The Comptroller of the Currency said, "It's 10 deposits." They had locked in on this issue so much so that the business of the FDIC had stopped. They couldn't agree on anything. I was appointed to break the deadlock, only nobody told me that ahead of time. I didn't discover the situation until I got there.

I had the swing vote. I didn't make a quick decision. I studied the matter for almost three months. The arguments were very balanced, and it was hard to decide which side had a better view. Finally, I went to Chairman Randall and said, "Are we an insurance company or are we a government agency?" He said, "We're both. We're agents of the government, but we do insurance." I said, "If it came down to having to be one, which would we be?" He said, "I'd say we were an insurance agency." I said, "It's been my experience that insurance companies that do not pay their claims on technicalities do not prosper." He thought for a minute and said, "I never thought about it that way. I'll vote with it, but we'll change the regulation to make it one deposit in the future right away." I said, "I agree with that."

The issue was settled unanimously, instead of a 2-to-1 vote. In the end, neither one of these two powerful, proud men had to be offended. Surprisingly, both sides of the equation accepted the solution. There was no big uproar, and it quieted down.

That may have caused the President to eventually nominate me to the Federal Reserve Board. He may have given me credit for more sense than I had because of the simple solution to a potentially sticky problem.

MR. SMALL. The insight was not to decide it instantly.

MR. SHERRILL. Yes. Not to fall for power saying, "I have the power of the swing vote." I could have gone in and made that decision just to show that I was strong enough to make it come my way. Instinctively, I didn't want to do that. First of all, I didn't know what the right answer was. I had not spent any time on that kind of problem. I needed time to understand the nature of the problem. Then I needed to know the two men involved. Randall and Saxon were powerful men. I needed to know their nature in order to decide whether they were biased or whether they were thoughtful about what was the correct view from a public policy standpoint—how do you settle the matter from a correct public policy standpoint? That's a feature often overlooked in present time. There's so much partisanship now that it's difficult to find people who are asking, "What's the best solution to this problem? What's in the nation's interest?" That's hard to come by these days, because we've got so much turmoil.

MR. SMALL. Did you have a sense that there was a Republican side of the issue and a Democratic side of the issue?

MR. SHERRILL. Not at all. President Johnson, a Democrat, had appointed both Saxon and Randall. Randall was a Republican, but he never gave me the feeling that he was a Republican chairman. And Saxon never gave me the impression that he was the Democratic

Comptroller of the Currency. They were both trying to do the best job they could do, and I admired both men.

MR. SMALL. Did you have reason to think that caught Johnson's eye?

MR. SHERRILL. I have no real idea. But he always enjoyed achievement in the arena of politics without too much pain. He was a consensus builder and a coordinator. He was an arm twister, but he would not move until you agreed that your arm had been twisted enough! He was not one to move arbitrarily.

Nomination to the Board of Governors of the Federal Reserve

MR. SHERRILL. I was 41 when I went on the Board of Governors of the Federal Reserve.

MR. SMALL. Do you know how it came to be that you were nominated for the Board?

MR. SHERRILL. I don't know, exactly. I have since learned that the vacancy was coming up for a 9-month period. Governor Chas Shepardson was going to retire 9 months early [on April 30, 1967] because of civil service requirements. Therefore, there was going to be a short 9-month opening before a full 14-year term became available.

William McChesney Martin, who was Chairman of the Federal Reserve Board, and President Johnson had a disagreement on filling the vacancy. I was not aware of this at the time; I was doing my job at FDIC. Martin was a legendary figure in Washington. He'd been there since Truman—through five Presidents—and everybody had huge respect for him as Fed Chairman. I had not met him in the 14 months that I was at the FDIC.

I received a telephone call from Chairman Martin. My secretary was smart enough to put him straight through without announcing him. The first thing I hear is, "This is Bill Martin. I'm Chairman of the Federal Reserve Board." I said, "Yes, Mr. Chairman, I know who you are."

[Laughter] He said, after the usual nicey-nice, “Could you have dinner with me Thursday at my home?” I didn’t know what my schedule was, but whatever it was, it was going to change. I said, “Yes, sir, Mr. Chairman.”

MR. SMALL. This is similar to your trip from Aspen when you didn’t know why you were summoned to Washington.

MR. SHERRILL. Again, I didn’t know what was happening. I was honored to have dinner with this great man. During the telephone call, he said, “Bill, would you mind driving yourself?” That means, “Don’t bring your driver.” That meant the meeting was confidential. I said, “Yes, sir, I understand.” Then he said, “My wife is in New York, and the staff has the evening off except for the cook. She will serve our drinks and our dinner. Then she has the evening off.” That meant the meeting was super confidential. I said, “Yes sir, I understand completely.” Then I hung up and sat there wondering what in the world this could be. The only thing I could think of was that I had lobbied two of the Fed Governors about the Regulation Q rates, the difference in spread between small deposits and large deposits. The FDIC largely has small banks, and there was quite a spread on what you could get on a $10,000 deposit versus a $100,000 deposit.

MR. SMALL. The Regulation Q ceiling.

MR. SHERRILL. Yes. I lobbied to narrow that.

MR. SMALL. Who sets these various interest rates?

MR. SHERRILL. The Regulation Q rates were set by the Federal Reserve Board for all institutions.

The only thing I could think I had done to the Federal Reserve Board was that lobbying. I decided that he was going to chew me out for sticking my nose in Federal Reserve business.

But I had always heard that he was a gentleman, so I assumed that he was going to voice his displeasure privately so I wouldn't be embarrassed. It was worth being chewed out to have a chance to meet this great man! That's what I was prepared for when I arrived that evening.

He met me at the door. We had a drink in his study. He had some Olmec artifacts. It's a civilization of early Mexico and a very distinct type of art from that era. I made a remark about the artifacts, and he said, "Oh, you know Olmec art?" I said, "I'm from Texas, and it's a nearby culture, so we probably see more of it than most people do." That was probably the first time he thought a Texan had any culture. [Laughter] So, in short, we got off to a good start. He was pleasant, and I was thoroughly enjoying the visit.

The cook served us and left. Martin said, "Bill, I wanted to talk to you." "Here it comes," I thought. Then he said, "There's an opening coming up on the Federal Reserve Board. Governor Shepardson has to retire 9 months early. I have two candidates for the job, but every time I bring up their names to the President, he brings up your name. Either one of these two men is better qualified than you." Just like that. [Laughter]

I was so relieved that he just wanted me out of his way. And I just wanted to be out of his way. I said, "Mr. Chairman, if they're qualified at all, they're better qualified than I." He laughed. It was a great icebreaker. I didn't want the job, and he didn't want me to have the job. We both realized that at the same time. We relaxed.

We chatted and had a thoroughly good dinner. In a little bit, he said, "Bill, what do you know about gold?" I said, "I don't know anything about gold, Mr. Chairman. I'm an American businessman. We're not allowed to own gold," which we weren't at that time. I said, "I've never given gold any thought." He said, "Well, what do you think about it as a monetary reserve?" Now, you have to understand, I was relaxed at this stage because I was past what I thought was going to be bad situation. I said, “To be candid, Mr. Chairman, I don’t think it’s very smart. I can’t find the relationship in my mind between the rate of expansion of currency around the world and the rate of mining gold.” He laughed and said, “Bill, you know more about gold than most people here in Washington.”

MR. SMALL. That was insightful, because that was the issue behind the special drawing rights.

MR. SHERRILL. I hadn’t an idea of all that. I hadn’t paid attention to that level of economics because I had not been involved in any way with it. It was the way I felt about it. It didn’t seem very smart. When I think about things, I usually think about effects—if they’re related or not.

Martin said, “You realize that if you were nominated, you could be charged with being a crony of the President and Jack Valenti. That would be embarrassing to the Federal Reserve Board.” I said, “Mr. Chairman, I never discourage anyone from labeling me a crony to the President of the United States, but I’m really not. I don’t know him that well at all. But I could be legitimately charged with being a crony of Jack Valenti. We’d been in business together, and we’re personal friends, so that it would be a legitimate charge. But it wouldn’t just embarrass the Federal Reserve Board, Mr. Chairman, it would embarrass me as well.” He laughed. We had a great evening. We really hit it off. He walked me out to my car and said, “Bill, I like the cut of your jib. I’m going to recommend you to the President.” That’s how it happened.

MR. SMALL. So it seems that you do your best when you’re unprepared and you don’t know what’s coming. [Laughter]

MR. SHERRILL. Shakespeare said, "Unto thine own self be true." It's really right. When you're just being yourself, you'd be surprised how much more attractive you are than trying to make yourself into something you're not. I have no doubt that if I tried to fluff myself and act like I was a monetary expert and the smartest guy on the block, he would have turned cold. I would have run him off. Because I didn't want the job, I could be totally relaxed about it. No side issues were bothering me. I was enjoying the evening with a great man—and I do consider him one of the greatest men I was ever associated with in my entire life. It was a great evening, and the outcome was a complete surprise to me. We had good relations from that point forward.

He asked me if I would mind being sworn in at the Federal Reserve. He didn't want it to happen at the White House. I was delighted. Then he said, "Would it be all right if I swore you in?" I said, "I would be honored." I realize now that from a public relations standpoint, he wanted it to appear very much his selection and not President Johnson's.

Being a Member of the Board of Governors

MR. SMALL. The story in some books is that Chairman Martin was pleased to get a businessman on the Board.

MR. SHERRILL. None of the Governors [were] qualified to head administration. Since I was trained in administration, I became available for him to assign the administrative portfolio. It had been rotated year by year because none of the Governors wanted it. I got that portfolio and kept it throughout. That's probably what he meant when he says that he was glad to have a businessman.

MR. SMALL. Martin is credited with building up the Federal Reserve System. He was involved in the choices for Reserve Bank presidents and in bringing them into the process. Did you observe that from the administrative side?

MR. SHERRILL. I wasn't an intimate witness to it, but I watched it happen from the sidelines. Being concerned with administrative matters, I kept up with who was leading what, and in that sense, I saw Bill Martin's strength.

The selections for Reserve Bank presidents were outstanding, and Martin made them cooperatively. For example, he gave me a shot at nominating someone for the Dallas Reserve Bank's board of directors, and I nominated the then-president of the University of Houston, Phil Hoffman, to serve. Martin was very good at getting where he wanted to go and having you enjoy going along.

MR. SMALL. He was interested in the Reserve Bank board of directors, not just the Reserve Bank presidents? He was interested in strengthening the boards?

MR. SHERRILL. As the direct leader of the Federal Reserve Board, he had to be interested. He was interested in the entire System.

MR. SMALL. Including the Reserve Bank boards of directors?

MR. SHERRILL. He had a great influence on who was selected to serve on those boards. He built strength throughout the System, not just at the Federal Reserve Board level.

MR. SMALL. His father was a Reserve Bank president in St Louis. Do you have any sense of that influence on him?

MR. SHERRILL. Well, he was—it's kind of funny to say it—of the nobility. He was a person of great class in his manner and in his execution. He had lived a privileged life and recognized it as a responsibility, not taking advantage of the privileges. He was a real representative of noblesse oblige, old school. He was a wonderful man.

MR. SMALL. He came up not through academics, but through the New York Stock Exchange.

MR. SHERRILL. He had been comfortable, as they say, all his life. But he hadn't used that comfort to enjoy himself. He employed himself in useful activities.

MR. SMALL. At the New York Stock Exchange, he came in as a leader of part of a reform movement against the old interests. Did you see that perspective in him as Chairman?

MR. SHERRILL. He was a dedicated public servant. He gave himself to what he thought was best for the nation. I'm kind of old fashioned that way. I took an oath to the Constitution when I enlisted in the Marine Corps. And for all my appointments by President Johnson, I took that same oath. I've always thought that an oath to the Constitution is an oath to the entire nation, not a segment of it—not a party, not an element, but the nation. And Martin felt very much that way. He tried to do the best job he could do for the entire nation.

MR. SMALL. Do you remember your early impressions of being thrown into the monetary policy mix? It was not a calm, peaceful time.

MR. SHERRILL. This was during the Vietnam War, so there were economic frictions over wartime society. The threat of inflation was always there. At that time, there was a conflict between monetary and fiscal policy. Fiscal policy was stimulative because of the war, and monetary policy was trying to counterbalance it. That put Chairman Martin in conflict with President Johnson. The President is always more associated with fiscal policy. Monetary policy is more independent. It was an interesting period of time.

President Johnson invited me to lunch after I had been on the Board about six months. He wanted to quiz me about my thoughts on monetary policy and what was happening. I explained to him that there was a real threat of inflation, that we had both a demand-pull and a cost-push going on. Therefore, we were likely to get inflation unless the fiscal side could be controlled. I'm sure that was not my advice alone. That year was the last surplus in the federal government for I've forgotten how many years.

MR. SMALL. Almost 40 years.

MR. SHERRILL. Yes. Johnson wanted to know what the right thing to do was, but he wanted it from someone he trusted. He trusted me. From what I'd seen in the six months on the Board, we were headed for inflation if we didn't do something to restrain ourselves. As it turns out, inflation came, and the latter part of the time I was on the Reserve Board, we were chasing inflation and raising the short rates outrageously. And we were considering a one-time five point jump in the short rate as a way to head off this inflation that we kept chasing. At that time, I recommended to the Board that we come out in favor of direct controls, price and wage controls. Of course it was a shock to the other Governors, because I had spoken against direct controls a couple of times.

MR. SMALL. The timing of this was when?

MR. SHERRILL. It would have been around 1970, 1971. The discussions of the Board went on for six months. Finally, the Board unanimously recommended direct controls. It was about that time that the former governor from Texas, John B. Connally, became Secretary of the Treasury [1971–72]. He had been a Democrat and became a Republican, and Nixon appointed him Secretary of the Treasury. I'd known Connally for a lot of years, so I went over and talked to him about my recommendation so he wouldn’t think I was crazy and that the Federal Reserve Board had lost it.

I can confidently predict that it was Connally who talked Nixon into actually doing it. I had nothing to do with the strategy that they used, and neither did the Board. They put direct controls in, and three months later they made adjustments for the worst inequities that occurred. A person who had just raised their prices was in great shape. One who was about to raise their prices was in terrible shape. Those kinds of adjustments were made after three months. After six months they watered it again; still, it was reasonable price and wage control. Three months later they watered it again. It was ineffective controls, and, three months after, they took it out completely. So it got in and out in a year, which overcame the biggest problem that direct controls have. They’re like a dam in the river. Once you put it in, you can’t take it out without flooding downstream. They avoided that by getting it in and getting a shock of stopping the price jumps and, at the same time, getting back out before it became unmanageable.

MR. SMALL. When you first came on the Board, Fed Chairman Martin; President Johnson; and Wilbur Mills, chairman of the House Ways and Means Committee, were fighting viciously over tax increases, spending cuts, and monetary policy. One claim is that Martin tried to influence that outcome by not being as tight with monetary policy as he might otherwise have been in order to let the economy get up a little head of steam, to let the problems become a little more apparent, to spur people into action.

MR. SHERRILL. I don’t think so. It was un-Martin-like. He was never Machiavellian. He was always thoughtful, always understood other people’s thinking. I rarely ever saw him devious in his tactics, so I would tend to doubt that that was the case. Certainly, I never heard him at the Federal Reserve Board encouraging anything except restraint. I have a hard time believing that.

MR. SMALL. You mentioned that soon after you came to the Board, you had a private meeting with President Johnson. From readings, the perspective is presented that Johnson had his poor Texas roots and did not like the idea of bankers raising interest rates, and that tax cuts would be the lesser of two evils, for the distributional effect of which hits the poor harder.[1] Do you think that's right? And did you have a connection with Johnson through your Texas roots, your family troubles during the Great Depression? Did that come into play?

MR. SHERRILL. Well, it came into play in Johnson's character and his viewpoints. He was basically a man of the people. He felt the pain that the people feel, so, yes, he was for those issues. His Great Society was aimed at alleviating some of those economic stresses on the lower economic classes. He was very interested. He was not quite a populist, but he was along those lines. It was from his roots, because he truly believed in the American dream.

MR. SMALL. Did he pressure you? Did his aides call over and say, "The President is heated about this or that"?

MR. SHERRILL. No, he didn't pressure me. When I had lunch with him, he had a set of questions for me. He didn't make one statement to me. He just kept pumping me and asking questions about monetary policy, the economy, and fiscal policy.

MR. SMALL. Was he trying to be educated and understand how it works?

MR. SHERRILL. Exactly. I definitely had the feeling that I wished I knew more, because he wanted to know more than I knew. When I ran out of knowledge, I told him, "I don't know anything about that." I felt badly that I didn't know more.

[1] Editor's note: Mr. Small intended to say that increases in interest rates hit the poor harder than tax increases.

MR. SMALL. Finally, in the summer of 1968, the Congress passed a tax increase. There's a commonly told story that the decision for the Board was: How much is this going to slow down the economy, and, if it's going to slow down a lot, we could ease, or maybe there's a political bargain here to ease. But that was a great forecasting mistake, because the Board was easier than it should have been, partly based on the forecast of the tax.

MR. SHERRILL. Yes. It was a period that everybody agreed on the forecasted future. That was the most general agreement that I experienced, and I came to distrust general agreements about the future.

MR. SMALL. That the tax increase would slow the economy?

MR. SHERRILL. Yes, because what I've discovered since then is that any time there is a uniform forecast, it opens up the portals for the rascals to try to make money off it, to try to find an angle that provides a short-term profit. As long as the herd's going this way, let's cut off the rear runners.

In this economy, as in all free economies, there are a certain number of rascals. For short-term profit, they will destroy a market because they have no stake in the long-term market. In their minds, they don't. Those are the ones that cause regulation. And they make it hard for people who don't think that way—responsible people—to not do irresponsible things because they were in competition with them, and they lead people in the wrong direction.

It's a great part of what happened to us very recently. There are some people who, without regulation, will take an immediate profit even though it's very destructive to the marketplace. That's going to be the real debate over what to do about regulation right now: How much regulation do you need? Anybody that says "Government is bad" or "Government is good" is mistaken. There's both bad and good government. It's the same thing with regulation: Good regulation is absolutely necessary, bad regulation is bad for the system.

How you have regulation that controls the rascals and, at the same time, allows the free, dynamic response of the market [and] is what we need to make our capitalistic approach work. That's the art of it. How do you regulate without suppressing and at the same time prevent people from destroying the long-term sustainability?

MR. SMALL. Getting back to 1967, 1968, and 1969 and concerns about inflation and the Board raising interest rates, there was the 1965–66 increase in interest rates and disintermediation out of the thrift industry. And monetary policy hit the housing and thrift industry hard, in part because of the Regulation Q ceilings. Was that influencing the next round of tightening a lot? You can't tighten too much, or the system is brittle once you hit the Regulation Q ceilings—we can't experience that again.

MR. SHERRILL. From my judgment standpoint, it did not. It wasn't that big an influence, as far as I'm concerned. That may simply be my lack of economic training, but it was not one of the guiding influences in my decisionmaking. The problem to me was clearly inflation. It started to run away from us. Like I said, it got away from us so far that I recommended direct controls. That's a draconian step, but that's the feeling I had about inflation getting away from us, because it really was moving fast. We chased it three or four times with rates, but we weren't slowing inflation down, it was speeding up.

MR. SMALL. During that period, what was the argument for not raising rates further?

MR. SHERRILL. Boom and bust—that when you cross a certain line with rates, you halt the economy. It's like a bursting bubble. It starts a drop in the economy that's much harder to contain. It's hard to contain, for one thing, because there are different points of view—

legitimately different points of view. When a bubble bursts, for reasons of self-interest, there are many people who want it to fall as far as it can before it recovers again. Other people involved in the fall don't want it to fall any farther than you can possibly keep it from falling because they're better off if it can be a softer landing. Within a free economy, there are all these viewpoints that have to be taken into account. You can't write off any viewpoint because it's selfish.

MR. SMALL. Were policymakers or public opinion sufficiently concerned about inflation? Was there a belief that a little inflation is okay, and there wasn't political support for stronger medicine?

MR. SHERRILL. It's always hard to garner support for inflation control because inflation happens when people are doing well or they feel they are, because the dollars are flowing and the profits are flowing. The fact that it's not sustainable doesn't worry many people. Only the people who know what happens if you let it keep going are going to want to stop it. Everybody else doesn't want it to stop because it really feels good.

MR. SMALL. During this period, you mentioned that, ultimately, it was going to end up in wage and price controls under Nixon in 1971, but, at the same time, the same endpoint comes to the Bretton Woods system. During your tenure, how much did the international come into play, and how obvious was it that things were going off track with the dollar and balance of payments and the whole Bretton Woods system?

MR. SHERRILL. International was always a concern to us on the Board. In those days, there was a saying that if the United States sneezed, the world would catch a cold. The United States was very dominant during that period, but, yes, [we were] concerned. Martin was particularly always concerned. An example: I had been on the Board a short length of time.

The French had been running our gold. Every time there was a French surplus, they'd not only buy gold from us, but they'd make us deliver it. It was aggravating. Then they had what was called "the events of May," I think, when their labor force rose up and demanded raises. All of a sudden they went from a surplus to a deficit, and they came to us the next month for a swap loan. I arrived at the office that day, and there was a call from Chairman Martin. It was rare for him to call me—almost everything transpired at the Board table. He said, "Governor Sherrill, I guess you've seen the item on the agenda for the French request for the swap loan." I said, "Yes sir, Mr. Chairman, I certainly did!" because I had expressed feelings about the French approach. He said, "I want you to think a minute about the fact that the world looks to us for guidance," and he gave me a wonderful, gentle lecture. I told him, "Mr. Chairman, you just ruined my whole day." [Laughter]

MR. SMALL. Because you were going to have fun putting it to the French!

MR. SHERRILL. I realized that I wasn't there to have fun. [Laughter] The answer is that we were concerned, internationally, but we were really in control.

MR. SMALL. There must have been times of concern that the whole thing was going to fall apart. There were problems with the British at times. The balance of payments deficit was huge.

MR. SHERRILL. There were times of greater concern, but I don't remember any crisis-type feeling during the entire time I was there. I never felt that there was anything that could not be straightened out. It might take some pain to do it, but it could be handled. I never had any loss-of-control feeling.

MR. SMALL. Do you have any memories of the role played by Alfred Hayes, the president of the Federal Reserve Bank in New York [1956–75], and how he interacted with Martin?

MR. SHERRILL. Martin and Hayes seemed to be good friends. Al Hayes had a gentlemanly approach to relationships, and I can only imagine it was that way with Martin, because it certainly was that way with the Board. He was a competent man and one that inspired confidence, but not an overbearing type at all. I never felt undue pressure from him. He was good at presenting his point of view and presented it thoroughly. I don’t remember ever feeling that he overstepped pushing his point of view.

Administrative Matters

MR. SMALL. Turning back to the administrative side, what were some of the administrative issues and initiatives that you undertook?

MR. SHERRILL. Well, the biggest administrative issue at the time was the transition period for technology. In my first Board meeting, I had determined that I wasn’t going to say anything. It was going to take at least one meeting to find out how uninformed I was, so I was not going to speak.

The issue of the computer came up. The Board was talking about the problems with the computer and that the problems were out of control. And they began to discuss going back to manual, getting rid of the computer. I couldn’t sit through that. My first maiden speech was that the Federal Reserve Board is in the information business. All we have is information. The handling of information without computers was an impossible thought, and it was going to get more and more so. The other Governors listened to me with absolute rapt attention. When I got through, the Chairman says, “Governor Sherrill, will you take the portfolio for the computers?”

So I got it and very quickly found out why they were distressed. They had made three moves simultaneously, any one of which would have caused a problem in any organization dealing with computers. First, they restructured organizationally. They had taken the computers from being part of the research department and made a separate department. This causes stress and strains in any organization. The research department was the heavyweight of the staff, so the move really offended the research department staff. Second, they had changed from a 1410 to a 360 computer. In those days, you had to reprogram everything when you changed computers. You didn't have emulators. You had to start again and reprogram everything. That would sink you, in most situations. Third, they changed the approach from an open shop—where anybody who had a problem could just sit at the computer and work on it—to having a queue where you had to submit your work. A professional worked the keyboard, gave you back the results, and then you made corrections and sent it back.

MR. SMALL. You submitted your punch cards?

MR. SHERRILL. It would have been punch cards in the 14-20, but the 360 was beyond that point. Any one of those three would have caused a major problem, and they did them all at once. So it's no wonder that they were having this absolute catastrophe.

I worked with the people and machine we had for about three or four months and realized that I would never be able to solve it with our resources. So I called in the head of IBM sales for the government, Bill Taylor, still a friend of mine, and I said, "Mr. Taylor, I have a proposition. I have a problem I can't solve with the resources I have. I need your recommendation of a machine. I'll lease it—I won't buy it—without bids on your recommendation. And I need to borrow the people from you who can run the machine so that I can get past this conversion problem. If you give me only the machine I need and you give me competent people and you don't use me as an experimental lab, I will go to Armonk and I will tell the chairman of your IBM board what a wonderful contribution you've made to your country. If you give me machines I don't need and people who can't run them and you use me for a lab, I will also go to Armonk and I will explain to the IBM chairman of the board what kind of man you are." Bill laughed and said, "Governor Sherrill, when you get through beating around the bush, I'd like to know how you feel." [Laughter]

He undertook the challenge. From that day forward, we got some first-class help loaned to us from IBM, and we started our conversion. It took about a year to turn it around, but by the time we got through with our own people in there, we had the second-best system to the CIA. We were better than the Army—in fact, we did hiring from the Army, some of their key people wanted to come over—so we had the finest thing around.

The other technology issue that had to be attacked involved the Reserve Banks. Because it favored competition, the Board had recommended that the various Reserve Banks get different types of computers. Competition for computer mainframes was big in those days.

MR. SMALL. A proactive recommendation.

MR. SHERRILL. Exactly. And the result was that they couldn't communicate with each other. That was another problem: How could the Board handle all these various computer languages coming in? The solution turned out to be what we call the "intelligent switch," which we put down in Culpeper, Virginia. It was a machine that would accept any one of these inputs in whatever computer language and convert to the common language we used at the Board. The Board received all the communications in the machine language that we could use. That solved the problem of gathering data centrally and analyzing it centrally on a timely basis. Those kinds of changes were imperative to the Federal Reserve keeping up with its work of analyzing information.

MR. SMALL. You said that they took the computers out of the research division. So it sounds like computers were used by economists to run regressions and models.

MR. SHERRILL. Exactly.

MR. SMALL. But there are other technological needs. There are simple things like payroll. There's tracking cash and checks and Fedwire. How did that development go about broadening the need for an improved payments system?

MR. SHERRILL. In those days, it was mainframe stuff, so there were no personal computers around. You could have one or more terminals on a mainframe. Once we made the next step, which we made with IBM at the time, we also had to invent the 360 dealing with more than one problem at a time—"sharing time," which is so common that you'd think it had been around forever, but it wasn't. Instead of one operator who couldn't keep the machine loaded—the machine was way too powerful for one operator to keep it busy—we had to share time so it would take on several problems and therefore could have several keyboards (terminals) and several inputs.

MR. SMALL. So the Board was instrumental in working with IBM and developing shared time and multitasking?

MR. SHERRILL. Yes. Shared time, intelligence switch—we were in on some of the very early developments of some of the things that have turned out to be basic now. Without them, the machine got so powerful that you couldn't keep it busy—like our brain, you could not make use of its full power.

MR. SMALL. At that time the Fed also had a lot of cash and checks that were moving around. What about the evolution of electronic payments and Fedwire?

MR. SHERRILL. The American Bankers Association had a committee called MAPS, Money and Payment System. I served on that committee as a representative of the Federal Reserve Board. They had only the bank wire in those days. All transfers—settlement of transactions between banks—were done on the bank wire. There was no Federal Reserve wire.

MR. SMALL. This was bank-to-bank?

MR. SHERRILL. Yes, bank-to-bank. It was the only way they could communicate. The banks had figured out that float was a great source of income, so there was a huge and growing amount of float in the system. Governor George Mitchell was the one who spotted this problem and highlighted it. He said, "We have to do something about it." But as much as we were trying to encourage the bank wire to be efficient and not have float, not hold transactions overnight or three days, still Mitchell was having no success in reducing float because it was too much in the banks' interest to have that float.

So we made a proposal: If they would eliminate the float, they would get prompt transactions [and] we would inject reserves equal to the float they would lose. Well, that didn't work, because they said the same people wouldn't get the money—it wouldn't be distributed in the same manner float was distributed—so they didn't accept that.

I approached Governor Mitchell and told him, "We now have the technology. We can do a bank wire. We can do this same transfer system with the equipment that we have set up and control the timing of transactions." He then got to work with our communications system, and he got the Fedwire designed.

MR. SMALL. So this means routing the transactions—instead of directly Bank A to Bank B, working through the Reserve Bank accounts electronically?

MR. SHERRILL. Yes, exactly. With the Fedwire, if you're a bank and you have a transaction occur in your bank that involves a second bank, you used to have to go to the organization called the bank wire, and you would delay the transaction and control when money left your bank. With the Fedwire, the date of your transaction was the date that you filed with the Fedwire. If you held a transaction the day before you submitted the wire, it showed right away. If you submitted it to us, we sent it to the other bank, and the other bank then worked with their clearinghouse. So it was the bank wire done by the Federal Reserve, and it put bank wire out of business and solved the float problem.

MR. SMALL. It's almost like some of the modern stuff, in the sense that the Fed has the name and the credibility—we don't play games.

MR. SHERRILL. That's right. We put regulation on it. After we had the Fedwire in place, we could say things like, "You have three days, max, to settle. If it's Podunk, Alaska, to Podunk, Florida, max three days to settle." Before we had control of the wire, they'd say, "We can't even see the money for four days." Once we controlled that, then we were able to control the speed, and, of course, the speed of a payment system controls a lot of the economy. You can't get as much done in an economy that takes a long time settling. If you settle instantaneously, you get a lot more done in the economy. Of course, back in those days, before [Fedwire], there were scratch checks (a blank draft check at most retail establishments) and all kinds of things that caused delays. Now, all these built-in delays, some for self-serving purposes, were down to what we considered reasonable delays, and we just passed the timing regulation. If you get money sent to you from another bank, you can actually get good money, max three days, but usually overnight.

MR. SMALL. So this takes some of the float out of the system, and it gives the Fed better monetary control over interest rates?

MR. SHERRILL. Yes, it gives better control of money flows. A slow settlement payment hurts the economy. What if everything had to be carried on a horse from one bank to another, and, therefore, it was 20 days before they got from one bank to another? Think what would happen to transactions, the ability to do transactions, under those circumstances. It wasn't that bad, but it was approaching that and getting worse all the time because of the volume of transactions created.

An example of what that means is that the New York Stock Exchange was studying how to automate its system. After we got ours under control, I started looking at their system and talking to their guy in charge and realized that they were just fooling around. I went to the Federal Reserve Board, and the Board said, "You will automate." The Exchange fought and fought, until one day they had—hold your breath—18 million shares traded in a day, and their system broke down completely. Now, how many do they trade in a day—280 million or something like that? It was clear that the system was not going to be adequate, so the Board insisted that the Exchange automate, and they automated. If they hadn't, it would have been a disaster.

MR. SMALL. How did the quick clearing times impact more generally the securities industry and high-volume trading?

MR. SHERRILL. It's settlement—from the time you make a sale until the transfer of ownership occurs—because it's all electronic. No money changes hands. You're recording your purchase on the books—their sale on their books, your purchase on your books. That transaction, back-office transaction, was getting delayed for two days. I don't have to tell you how many evils can take place in that situation.

MR. SMALL. You might not think it's so bad for a local business like a hardware store, but for securities trading—

MR. SHERRILL. It can be deadly. So those were the transitional problems and technologies—

MR. SMALL. A lot of them seem to have been started at the Fed.

MR. SHERRILL. Yes, they were either done by or driven by the Fed.

MR. SMALL. Especially on the software side, about this multitasking.

MR. SHERRILL. Yes. In those days, software wasn't as big as hardware. The way you got more power was to get a bigger machine. Following that period, it became clear that we could get more power out of software than by increasing hardware. As a result, you've seen what happens now. Those were pretty ancient days of information technology that we're talking about.

MR. SMALL. This whole experience seems also to attest to the diversity of talents that the Board needs.

MR. SHERRILL. Right.

MR. SMALL. You're a practical problem solver with a lot of experience. You see the value of technology. You get in there, whereas people from different backgrounds might have thought, "Well, that's not important."

MR. SHERRILL. I was administratively trained. That's the way I thought. How do you improve productivity? How can we be more efficient and most cost effective? When you're trained in it, that's what you focus on.

It saved my ego, because I was so ignorant about monetary policy and economics. I was learning that as I went along. When I went on the Board, I was the dumbest boy in the class, and that wasn't something I was comfortable with. I worked hard at monetary policy and economics for two years, and I was still the dumbest boy in the class. [Laughter]

MR. SMALL. On the administrative side, did you have experiences in managing or developing Board personnel and staff?

MR. SHERRILL. There was one amusing issue. In those days, dress styles were changing rapidly. For a time, there was the miniskirt, for example. And every time there would be one of those new styles, the head of human resources would get complaints. He'd come to me with them, and I'd say, "Let's study it for a little bit." Then people would get used to the style of dress, and the issue would go away. But then hot pants came along with the accompanying complaints. I said, "We'll study it." We studied it, and the complaints continued. I said, "Okay, form an employee committee, load it with young women, study it, and tell me the recommendation of the committee." I thought that would surely have the issue go by, but it didn't. The committee recommended that hot pants be banned.

Now, all of a sudden I have a problem on my hands that I can't ignore anymore. I spent a day writing a memo to the staff. It started off with how we were an intellectual community, how we worked closely together with great tolerance of each other, how we had avoided a dress code in the interest of being accommodating, and so on. It ended with a ban on hot pants.[2] It

[2] William W. Sherrill (1971), "To All Members of the Board's Staff," memorandum, Board of Governors of the Federal Reserve System, June 8.

wouldn't have been so bad if a local columnist hadn't picked it up and written a column about how the Federal Reserve spends its time in secret coming up with great policies, and used the hot pants ban as an example. Of course, the columnist really stuck the needle in.

Governors were very polite. Administration was my area, so nobody said a word to me. But one day, as we were leaving for lunch, Governor Brimmer couldn't stand it any longer and said, "Governor Sherrill, you might have consulted us on that dress code policy." I said, "Governor Brimmer, if I'd been angry with you, I would have." [Laughter] It's like sharing the measles. Nobody really appreciates that.

MR. SMALL. During this period of the Vietnam War, were there issues about the advancement of women and minorities in the organization?

MR. SHERRILL. That issue wasn't as big as it became later. The time period was a little ahead of the real female equality movement, but then the Board didn't have that much inequality. The Board tended to be more intellectual. It was more like administering a college than running a business.

One way I learned that: I introduced planning, programming, and budgeting because we had no budget system, and we were beginning to take on matters like implementing the Truth in Lending Act of 1968.[3] Various programs start small but they grow large, and you have to plan on that. Some programs start big and die off. So the shape of things to come and responsibilities you're taking on will change, and the impact on the organization over the ensuing years will be different. Planning, programming, and budgeting were designed to take the future into account. It was a very modern type of financial planning at the time. I installed that.

[3] The Truth in Lending Act of 1968 was the first comprehensive consumer credit law enacted by the Congress. It required creditors to give consumers uniform information about the cost and terms of credit. The Federal Reserve Board was given rulewriting authority.

At the end of the first year, I received budget reports from the various departments [and] divisions. Most of them made an attempt, for better or worse, to refine their budgets, but the large research division made no change. I sent my people to work with their people to instruct them. Then the second year came. I went into the budget meeting. The way it worked was that my staff sat on one side of the conference table and the department head's staff sat on the other side. And, by protocol, the department head and I would come in last.

MR. SMALL. Was Dan Brill the director of the Division of Research and Statistics?

MR. SHERRILL. No, it was Chuck Partee. Dan had moved along. Ordinarily, the staffs would be joking with each other. I walked into this room. They were all just sitting there, and I knew something was not good. Chuck presented his budget, and it was the same old input budget. And he ended with an unfortunate statement. He said, "I guess the best we can say is that we've kept our nose above water this year." I said, "No, no, Chuck. You underestimate yourself. You've learned to breathe underwater." And I walked out.

It was a cause célèbre. The R&S division put in planning, programming, and budgeting, even though Chuck didn't speak to me for two years. That was one of the prices to pay to get something the organization really needed. Because of the rapid extension of the Board's responsibilities, we might have lost control of our internal finances. We could have been jumped on by outsiders. Luckily, everybody was prudent in their expenditures. Chuck was prudent, but he was subject to budgetary surprises that could have been embarrassing for the Board.

It was trying to head off that sort of thing that drove me to those more extreme actions. Ordinarily, I dealt with Chuck most respectfully, because you can't hire brains like that at this price in a business. People like Chuck worked at the Board because they enjoyed the intellectual community. I realized that I was dealing with the most precious commodity we had, but at the same time we couldn't allow an outright refusal to follow a direct order when that order was important. It was calculated, on my part, to be as tough as I needed to be, but not to be that way unless it was necessary.

MR. SMALL. During the 1960s in general, there was a lot of pressure from the Congress on Fed independence and its financing and accounting.

MR. SHERRILL. Up until that point, the Fed had never had a formal budget.

MR. SMALL. Or outside accounting?[4]

MR. SHERRILL. Yes. At the Board, each unit just said what funds it needed. That was the way it worked. Everybody was prudent and funds were unlimited, because you know how the budget works. The Federal Reserve draws the interest off the bonds in its vault, so there was zillions of dollars of income, of which we take the amount needed to run the System. Then the balance is refunded to the Treasury annually. It wasn't a money issue. It was really a control issue—a responsibility issue is the correct way to put it.

MR. SMALL. Because you'd be more liable to charges from the Congress that you weren't a good custodian.

MR. SHERRILL. Yes, as soon as some surprise happened. When we took on the Truth in Lending Act, it was only this big, but next year it got bigger, and by the third year, as I said, we could have been overrun with it. The question would have been asked: "Why didn't you predict that sort of thing?" We were trying to avoid that.

MR. SMALL. Were there efforts at coordinating with Reserve Banks or at least understanding what they were doing on budgets and information technology?

[4] Editor's note: Since 1952, an independent public accounting firm has audited the financial statements of the Federal Reserve Board annually. Beginning in 1996, the Board has ordered an annual independent audit of the financial statements of each Federal Reserve Bank as well.

MR. SHERRILL. We just checked to be sure they were planning properly—not to tell them how to do it, but to be sure they were up-to-date in the planning business. And they were. We were the only ones needing to play catch up.

Highlights during Tenure at the Board

MR. SMALL. What were some of the highlights during your time at the Board?

MR. SHERRILL. There are three things that I think were of reasonable significance. First were the advances we made in information technology while I was on the Board. I think it made possible the efficient operation of the Federal Reserve System. I think it was necessary to have a leading edge in information technology, because, after all, the product of the System is information. The ability to gather timely information, to massage it, and to produce analysis of it in a timely manner is critical to the Federal Reserve Board and its operation.

Second was going off the gold standard. In my judgment, gold as a monetary reserve had a tendency to restrict growth. Those who advocate the gold standard believe its purpose is to avoid uncontrolled growth. But to tie the growth to mining of gold doesn't seem any more intelligent today than it did before I went on the Board. I think going off the gold standard let the world grow at its sustainable rate. Occasionally it's gone beyond sustainable growth, but I don't think that would have been controlled by gold. I think gold would have had a depressive effect if it had remained a part of the monetary system.

Third was the Fedwire. The Fedwire allowed the money and payments system of the United States to function in a way that it can handle both capacity and timeliness to facilitate transactions, and that, after all, is one of the basic functions of the Federal Reserve. Moving to the Fedwire and getting rid of the excess float in the system was an important development. Those three are probably the most significant things of the time I was at the Board.

MR. SMALL. As much of an advancement as that was, Fedwire carried certain risks. There was the Herstatt Bank, which closed while markets were open, and there were certain fragilities or exposures that were only learned, somewhat painfully, over time.

MR. SHERRILL. Yes, and critics of the Fedwire were quick to jump on its early problems. But the problems it had or created—versus the problems solved as a result of the Fedwire being in place—were miniscule. Fedwire solved huge problems and had minor problems, so I think that, all in all, it was a major contribution to our ability to do business in the United States.

Chairman Martin

MR. SMALL. Do you have any stories or anecdotes that might shed light on the personal side of Chairman Martin?

MR. SHERRILL. Chairman Martin was an avid tennis player. At one stage of his life, he played at Wimbledon. He was an interesting amateur tennis fan. He played every day on the Fed court. It was in the parking lot behind the Fed building. When we decided to build the annex to the Fed, it was going to be built on the parking lot, and, therefore, the tennis court was going to be eliminated. Chairman Martin wanted the tennis court to move onto the adjacent national park, which was under the jurisdiction of the National Park Service. When he asked to have the court put in it, he was refused, and he came to me to ask if I had any connections at the White House that might get him some extra consideration on getting his tennis court.

I called the President's number one assistant, Marvin Watson. He was a Texan, and I knew him personally. I told him what I wanted, and he laughed. I said, "Don't laugh. This is serious business!" He said, "I'll be willing to put in a call for you, but you owe me one." The next time I went to the National Park Service, they had a sudden change of heart, and they said, "Okay. The reason that we didn't want the tennis court in the park was that the park is designated for passive recreation, not active recreation. But if we sink the court halfway and build berms for people to sit and watch the tennis, then I think that would be passive recreation, and, therefore, we'll do it." So whatever the reason, the Chairman was grateful to have his tennis court back.

In another instance, the Chairman asked if I could get Congressman Wright Patman to agree to allow wine and champagne to be served in the Federal Reserve building for a dinner with the governor of the Bank of England and his wife to reciprocate for a trip our Chairman had had over to the Bank of England. Since alcohol was barred from federal buildings, he needed special permission from congressional oversight, and that was Wright Patman. Patman was a great Texan and populist and supporter of President Johnson and, by extension, being a Texan, a supporter of me. I called him and told him, "Mr. Chairman, we really need to do this. It is appropriate we do this for them because they've done it for us." He said, "You think it's appropriate?" I said, "Yes, Mr. Chairman, I really think it's appropriate in this case." He said, "Make the wine and champagne domestic," and we got approval to do it. It was those sorts of things, little instances that added a little spice to the whole trip.

Arthur Burns Chairmanship

MR. SMALL. Arthur Burns was appointed by President Nixon and became Fed Chairman on January 31, 1970. Was there much change when he came on board?

MR. SHERRILL. It was a change in personalities more than anything else. Chairman Burns was an academician and had come directly from the White House staff. Burns was a gentlemanly, scholarly type and not as well versed as Martin in the financial markets and the financial side, but Burns was a great economist. His field of specialty was the business cycle, so he brought a new type of expertise to the Board, and a different type of personality, but one that was easy to get along with and caused no problems.

I turned in my resignation as the Administrative Governor and the portfolio, and he immediately gave it back to me, so I continued to be Administrative Governor. He tended to ask my advice about administrative matters. On one occasion he asked me for advice that surprised me. I had arrived late in the morning to the Federal Reserve Board, and there was a call from the Chairman's office saying, "Come to the Chairman's office right away." Ordinarily, that call would have been phrased, "At your convenience, could you drop by the Chairman's office?" I knew by the nature of the message that it was something more than ordinary. I went to his office. He was a studious man and a pipe smoker. Ordinarily, he would be puffing his pipe and sitting leisurely in his chair, but he was walking around his office, pipe out of his mouth, and he was obviously agitated.

As soon as I closed the door, he said, "Did you see the morning newspaper?" I said, "No, Mr. Chairman, I haven't had a chance to look at it yet." He said, "Take a look at this," and he handed me the front page. It was a story from an unnamed White House source that the Chairman of the Federal Reserve Board, Arthur Burns, while preaching economy to the government, is seeking a raise for himself. He was outraged. His honor had been attacked.

It turns out that it was a recommendation I had made to Martin, and he turned it down—that the Chairman of the Federal Reserve be advanced in grade to the level of the Supreme Court Justices and be paid accordingly to that level. When Burns approved it, he specifically said that the increased pay would only go to his successor so he would not benefit. I wrote the recommendation and forwarded it to the White House, so I knew that that was the circumstance.

He said, “You know this is not true.” I said, “Yes, Mr. Chairman, I certainly do, since I wrote it.” He said, “Well, I’m going to call a joint session of the House and the Senate and point out that this is a lie, that this is absolutely not true.” I said, “Mr. Chairman, you’ve got much more experience at this sort of thing than I do, but could I make a suggestion? You’ll notice the phrase, ‘an unnamed White House source.’ That means this came from somebody on the President’s staff, so if you attack this, it’s an attack on the President. If you attack one of the President’s staff, the President has to answer, he has to defend them, so you’ll create a problem, and the nation doesn’t need a fight between the Federal Reserve and the White House. So if I could make a suggestion, I would call the reporters here, rather than involve the Congress, and say how unfortunate it is that someone would leak this story to the press when they know it isn’t true. It isn’t true because—and you cite the circumstances. If you’ll do that and just say how unfortunate it is that this happened, I think the President will call you within three days to apologize.”

Burns followed that course of action, and two days later, President Nixon called him to apologize. It turned out that the story was leaked by the fellow who eventually went to prison, Charles Colson.[5] He had been a political enemy of Chairman Burns and had leaked the story to injure Burns. As it turns out, it made no injury at all. It did not disrupt the relationships between Nixon and Burns. That’s the most important part of it—the nation doesn’t prosper when there’s a fight between the White House and the Federal Reserve Board.

MR. SMALL. You said that you thought Burns was easy to get along with?

[5] Charles Colson was special counsel to President Richard Nixon from 1969 to 1973. Colson was indicted, though not convicted, for conspiracy to cover up the Watergate burglary. He later served seven months of a one- to three-year prison sentence for obstruction of justice in the Daniel Ellsberg case.

MR. SHERRILL. Yes, he was, because he was very thoughtful. An interesting insight into the way he thought: I got a call from his office that we had an attorney on our legal staff who had a tax conviction, and that we needed to do something about it quickly. Being Administrative Governor, I checked on it, and it was true. The attorney had gone through a divorce. He lost all his business concerns, failed to pay his taxes, and did, in fact, have a conviction for failure to file. I called him in, and right away he said, "I knew I shouldn't have come to the Fed in the first place because of this. I've been looking for a job already." I said, "How much time do you need?" He said, "Could you give me two weeks?" I said, "How about 30 days?" He replied, "That's plenty of time." I called the Chairman and said, "I have his resignation in hand, Mr. Chairman. I didn't know how much time you wanted to give him." Burns said, "No more than six months." I said, "Mr. Chairman, I have in hand, signed with his agreement, in 30 days." And Chairman Burns—he had this funny laugh—he said, "Huh, huh, huh, I could learn to love you." [Laughter] He was pleasant to work with, no problem working with him at all.

MR. SMALL. It's possible to be both pleasant and demanding?

MR. SHERRILL. Yes. He definitely had standards. The standards were more academic than commercial. I was used to commercial things, so 30 days to get out was a pretty good length of time. In academia, six months is standard. He was used to that sort of administrative background, if I could put it that way. In that sense, I was constantly pleasing him because my time frames were always shorter than his.

MR. SMALL. But he drove the staff hard on economics, on analysis?

MR. SHERRILL. His knowledge of economics was much greater than Martin's, so the staff and he coordinated a lot more in making the recommendations to the Board. The staff studied the issues, and then they were presented to the Board. In that study, the Chairman and his assistants, people around the Chair, are directly involved with that type of research and study, so they're well informed as it goes along. The way the system worked—and I assume it hasn't changed—is that at Board meetings, five Governors who are not the Chairman or the Vice Chairman sit on one side of the table, and the Chairman and Vice Chairman sit on the other. Any discussion starts with the most senior Governor who is not the Chairman or the Vice Chairman and then proceeds down in order or seniority to the most junior Governor. Then the Vice Chairman and finally the Chairman speak on the matter. The first round is discussion, and by the time it gets to the Chairman to speak, he knows where everybody else stands on the issue. He makes his statement and then calls for the vote, if that's appropriate. The vote comes around, and at the time you vote, you restate your position, not just a yes or no. You restate your position and you can get some changes on that vote because of the views expressed by the other Governors. By the time it gets to the Chairman's turn, he knows everybody else's vote.

It is incumbent that the Chairman not lose. If the Chairman is not especially concerned with the outcome, he will find some basis for changing his vote to be on the winning side. If it's a matter of conscience for him, he can ask for the issue to be taken off the table for now, restudied by the staff, or some other method of giving more time to sell his point of view, and that's perfectly acceptable to the Board. Eventually, he will have to change his vote if he's in the minority, in order to be on the winning side. Only one Chairman in the history of the Federal Reserve has ever been voted down publicly by the Board, and he remained Chairman for an additional six months because the system simply lost confidence in him. It's set up so that the Chairman can't lose and that he will represent the Federal Reserve in everything he says.

The concept is to have the public accept the Chairman as speaking for the Board and not have a divided voice. The Board has to do pretty onerous things at times—it has to take an action that might put a million people out of work. When that happens, you don't want a divided Board to be speaking. You don't want it to sound like one man could change his vote and the million people didn't have to be unemployed. It's set up for a very good reason and—while I was on the Board, at least—widely respected.

MR. SMALL. Chairman Martin believed in maintaining the value of the dollar. He was strongly against inflation, but, when all is said and done, he left the Board with inflation higher than when he started. Did you have a sense of his frame of mind or spirit when he left the Board in January 1970?

MR. SHERRILL. He had some tough years at the end of his reign. He really wished he could have been more effective, and he was the first to say so. Overall, as he looked at his career, I believe he was satisfied with his overall performance. He was kind enough to write me a letter in which he stated some of the satisfaction and was kind enough to say that I was one of the bright spots of his final term in office, so I know that he was certainly not depressed or discouraged by it or felt that he had not been constructive.

MR. SMALL. He came to the Board in April 1951 after having negotiated the accord when he was at the Treasury Department. That was a major increase in Fed independence. Do you think he was concerned about independence being taken away, or do you think he felt it was well established?

MR. SHERRILL. He was concerned constantly about that, because he felt it was so important. It can be seen when you get into those periods in which fiscal policy and monetary policy conflict—which we got into during my period, where the fiscal policy was stimulative and the monetary policy was trying to restrain the economy. It's in those periods that you recognize that if you didn't have independence, those periods would never exist, and, therefore, when over-stimulation came, it would be real overstimulation and overrestraint, although I can't imagine that in fiscal circumstances. [Laughter] Overrestraint would be equally undesirable.

MR. SMALL. Do you think he was conflicted over picking between the lesser of two evils—one evil might be a little too accommodative, the other evil might be losing independence?

MR. SHERRILL. Well, I don't think he felt that was the basis of conflict. As most of us did, he felt almost constant conflict on stimulate or restrain—or, how much stimulation, how much restraint. I think he felt that kind of conflict. But as far as having to modify his policies in order to maintain the Fed's independence, I don't think he would have had the struggle with LBJ on my appointment if he was willing to subordinate policy for independence, because at that stage of the game he was clearly standing directly against LBJ's wishes. And when I went to see him, as I told you, his opening remarks let you know how he felt about me being proposed, so clearly he was not afraid to stand in the face of the President.

The famous instance at the President's ranch, when he literally gave the President a lecture, shows that he was—I won't say "fearless," because I don't know what was in his heart—willing to stand against pressure that could be pretty hard, because when LBJ wanted to be tough, he was a pretty tough man.[6]

[6] In December 1965, President Johnson met with Chairman Martin at the President's ranch in Texas. The Federal Reserve had increased the discount rate, even though Johnson, through his staff, had advised Martin to delay the increase. The President was annoyed and contemplated Martin's resignation. In the famous meeting, Chairman Martin diplomatically argued the Fed's independence and was not forced to resign.

Current Views about the Fed and the Financial System

MR. SMALL. Since you left the Federal Reserve Board, what are your thoughts about the Board? Where has it succeeded? Where could it have done better?

MR. SHERRILL. This last period, especially, it could have done a lot better. The problem was that it did not have the tools or the authority to make the financial system as transparent as it needs to be, and, therefore, things happened in the financial community that the Fed was unaware of, or at least unaware of the extent of it. An example is the credit default swap, which in practice sounded innocuous when it got started. I don't think that the Fed would have stood by and watched that get to $65 trillion around the world if it had been aware of its size. I think it would have made a lot more noise and tried a lot harder to head that thing off, although it wasn't directly within its authority. The concept of calling it a credit default swap is simply because, legally, it couldn't be called insurance. Credit default insurance is what it is. It has a couple of problems being without proper underwriting and without an insurable interest.

MR. SMALL. If it had been insurance, it would have been under different regulation and supervision?

MR. SHERRILL. It would be under regulation set by the states and, therefore, essentially unregulated. There wasn't a way to stop it legally except by taking them to court. Essentially, insurance has two requirements. One, there must be reasonable underwriting. There must be some knowledge of the risks involved. Two, there must be an insurable interest. You cannot get insurance on somebody for whom you do not have an insurable interest, lest you take it on a stranger and murder him. The requirement is there for a real reason.

With those two restrictions, taking a look at credit default swaps, the first thing is, you sell me a bond issue and I'm worried you can't pay, so I go get insurance. That's the credit default swap. But that's bad enough, because at least I have an insurable interest. The underwriting may not be much, but at least I have an insurable interest.

But then, people who had no connection with this transaction went and got the same credit default swap on the bet that you won't pay. That's gambling. And what happens, in effect—if I have an insurable interest and you default, I simply get my money back. But if I don't have an insurable interest and you default, I get a huge profit, because all I've invested was the premium cost. That's what insurance is about, but it certainly isn't meant for gambling purposes—$60 trillion of the $65 trillion was gambling. Had the Federal Reserve been aware of it, I'm sure—whether or not it had the authority—it would have raised serious questions about that.

MR. SMALL. Currently, there is some worry that inflation is too low.

MR. SHERRILL. Yes. There's so much money out there, if that money isn't reabsorbed as we start to grow, that's one of the Fed's problems. When we have a recovery is not certain now. The Fed has to decide we have a recovery before it goes to restraint rather than stimulation. Once the Fed decides on restraint, then the question is how much restraint. If the growth is too fast, then inflation's almost certain. By nature, the Fed is going to have to restrain growth. It can allow growth up to 5 [or] 6 percent and still reabsorb the excess liquidity, because the way you reabsorb that money is with growth. The way we get rid of the deficit is with growth, so growth is good. Too much growth and you get inflation, too little growth and you haven't solved the problem. Not too hot, not too cold, just right. That's the Fed's problem today, and it's a tough one.

MR. SMALL. You came to the Board with a banking background. Do you think that it is crucial for the Board to have bankers on it?

MR. SHERRILL. No, I don't think so. I think a business person would have a wider application than a banker. There's nothing wrong with a banker background for the Board, but if I had to choose one or the other, I'd choose a businessman over a banker. If I could choose a businessman banker, I would like it even more.

MR. SMALL. And if you were the czar of banking regulation or financial industry going forward, how would you structure things?

MR. SHERRILL. First, I would put back the Glass-Steagall barrier between commercial banking and investment banking. It's my belief that they're two separate fields. I'm talking about the prohibition of a commercial bank owning an investment bank, or an investment bank owning a commercial bank, or a holding company owning both. It's a barrier where if you're going to be in commercial banking, you can't be in investment banking, or you can be in investment banking, but you can't be in commercial banking. With that back in place, we can afford to protect commercial banking and get on with having it operate in a much more conservative, less-risk fashion, and, of course, less earnings as a result of that. But then, customers in that area are protected, and the banks themselves are protected. We have government guarantees there, government backing.

On the investment banking side, I would not have any government guarantees. If you want to invest your money and take a chance, that's fine. You decide the degree of risk you want, and you make your investment. If you lose it, you've lost it. There would be no government guarantees on that side. Rescuing the investment banking side would not be a part of my thoughts, but I would put in some constraints on that side: one, transparency, so we could see if anything like the credit default swaps was growing to the size it was; and, two, I would put in the type of restraints that keep one unit from being too big to fail, which I think is absolutely essential.

That's the structure I would head for. Whether or not we get there is going to be a serious problem, because it's unscrambling the egg. Right now, if you were to break apart the existing commercial bank–investment bank combinations, commercial banks would have to become a very conservative low earner, and investment banks would be the big earner and have big returns. Getting agreement on this change would be tough. I think, as tough as it is, that's the sort of thing we need to do.

MR. SMALL. You mentioned that you wouldn't have an investment bank and a commercial bank in the same bank holding company. The bank holding company has been seen as a vehicle to manage risks in the banking or financial system. Do you think the bank holding company is a viable concept?

MR. SHERRILL. The bank holding company for commercial banks—a holding company cannot have an investment bank and a commercial bank, but it can have a number of commercial banks. I would go for that holding company. And under the one-bank holding company law, they could enter what was called at the time "consanguineous" businesses—that is, closely related businesses to banking. The one-bank holding company had more stresses and caused more problems than people imagined when it was created, but I still believe that could be viable, if you kept the nature of those businesses—like credit card businesses, retail lending businesses, that sort of thing that are essentially in the commercial banking field of regulated finance—if we limited the bank holding company to that structure, I believe it could still work.

MR. SMALL. Do you believe in keeping commerce distinct from banking—for example, keeping Sears from owning a bank?

MR. SHERRILL. Yes, I believe that the banking function should not combine with commerce. When it fails, who protects it? How much protection do you give Sears if the whole thing fails? If the bank is held forth to be the reason Sears is going down, does Sears have a right to ask for the protection given the bank? In my world, the way I would construct it is, that would not be allowed.

MR. SMALL. So you're close to the Volcker rule?

MR. SHERRILL. Maybe even a little tougher than the Volcker rule.

MR. SMALL. Around 1979, things were going poorly with inflation and the dollar. The Board had new operating procedures, and interest rates were heading up. What were your thoughts?

MR. SHERRILL. At that time, I was not watching carefully. I had been in real estate in Houston, and I sold out in 1980 and went into electronics in Boston. I sold out not because I foresaw what was coming, but because I was sick and tired of real estate. I'd been doing it for a long time. I had seen it bob and weave, and I just lost interest in it. I got into electronics in the Boston area and looked like a genius, because electronics were just taking off. When my friends asked me, I'd tell them, "A little foresight always helps," but I really just lucked out. I changed for an entirely different purpose.

MR. SMALL. What did you think of Volcker's chairmanship and what he was doing?

MR. SHERRILL. At that time, I thought that the System was going to need someone like Volcker. We had tried all these milder ways. And, remember, I went draconian with direct controls at one stage. I saw what can happen if inflation gets away from you, and it's not easy to control. It was either Volckerism or direct controls again, and I liked Volckerism better. I think he was the right man at the right time.

MR. SMALL. Looking forward, do you have fears about federal deficits—too much of a reaction and overregulation? Are there concerns for the U.S. economy going from 2010?

MR. SHERRILL. It's going to be a tough time for regulators to handle this thing properly, because the risk of inflation in the future is still out there and very real, but it is in the future. I would say that the possibility of inflation in the next two or three years is low. What is risky in the immediate future, in my mind, is a second downturn, a double downturn, which then would remove the inflation problem for a long time, but would make a miserable circumstance out of our economy. We need to do whatever it takes to get jobs started. If we can get the jobs started again, we can get out of this thing. If we don't get the jobs started, we won't get out of this thing. We're not going to do it by the present method of GDP recovery through principally cost cutting. A little bit of technology improvement, productivity—but the most productivity we have today is out of cost cutting, and that's a one-act play.

MR. SMALL. Thank you for your time.