STATEMENT BY CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM[1]

In coming before you today I should like to express what I know has been in the minds of all of us in the Federal Reserve System in preparing the answers to your questionnaire. We have welcomed this opportunity to put down on paper our concepts of what our function is in the governmental structure and in the economy. You gave us a heavy load of homework and we have all profited by it. I know that for me it has been more than a refresher course—it has been a liberal education in what I prefer to call reserve banking, rather than central banking operations. The task of preparing answers to the comprehensive and searching questions has been formidable and I will not pretend that I approached it without some reluctance. Now that the task is done and the results are published I realize how worthwhile has been the time and effort expended not only by those of us in the System but by the many others to whom you addressed questionnaires. Irrespective of the conclusions you may reach as a Committee, you have assembled a body of information that I think will prove to be invaluable for a long time to all who are interested in the special problems of general credit control and debt management.

Beyond that, however, we have all genuinely welcomed this inquiry. The Federal Reserve System is a servant of the Congress and, through you, of the people of the United States. You created it, you can abolish or change it. Our task is to carry out your will and it is our duty to lay before you all the facts at our command for which you ask and to give you our best judgment on these important matters.

We are glad of the opportunity to make any contribution we can to the improvement of this reserve banking mechanism. Like all human institutions, it is not perfect or infallible. In the nearly four decades of its existence, the System has undoubtedly made mistakes. It has also learned from experience. One of the fundamental purposes of the Federal Reserve Act is to protect the value of the dollar. Yet that value today in terms of purchasing power is less than half of what it was when the System was founded. In this span of years the country has engaged in two world wars and is now in the throes of what might be called an undeclared war. With the vast economic changes brought about by military and security needs, monetary policy by itself cannot maintain economic stability and preserve unchanged the purchasing power of the dollar. Even aside from these disturbances, it is probably fair to say that monetary policy has not always been as timely or as effective as it could have been.

Your first concern, I take it, is to look at the record of the past principally for the light it can throw on the road ahead. We are trying to look forward, as you are. In his first inaugural address as President, Woodrow Wilson included a statement, part of which is inscribed in the foyer of the Federal Reserve Building:

> We shall deal with our economic system as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon; and step by step we shall make it what it should be, in the spirit of those who question their own wisdom and seek counsel and knowledge, not shallow self-satisfaction or the excitement of excursions whither they cannot tell.

I am sure it is the purpose of this inquiry, as it is of all of us, to appraise judicially this reserve banking mechanism and to do whatever appears wise so that it may render the best possible public service.

The Federal Reserve System and the Federal Reserve Banks sometimes are referred to as bankers' banks, but that describes only a part of their functions. The various services which the Reserve Banks perform for the banking community, such as supplying currency, transferring funds, and collecting checks, have proved to be an essential element in keeping the mechanics of modern-day commercial banking in step with the financial needs of a growing and changing private enterprise economy. The overriding purpose of this Reserve System is to serve the interests of the general public in business, industry, labor, agriculture, and all walks of life. As I understand the intent of this inquiry and of these hearings, it is to explore how that interest of the public can best be served in the area of general credit control and

[1] Statement of Wm. McC. Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, Mar. 11, 1952.

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debt management on which the activities of the Federal Reserve System have so important a bearing. The approach to this broad subject by the members of this Committee and of the Banking and Currency Committees and those of us to whom you entrust the duty of carrying out your wishes must be in the spirit to which Wilson referred. We must always question our own wisdom and seek counsel and knowledge.

Considering that money is one of the most controversial of all subjects, it is rather remarkable that the replies elicited by your questionnaire reveal so little fundamental divergence. Honest judgments may differ as to whether the Reserve System, for example, has done its job well or poorly. There are bound to be differences of opinion concerning the structure and internal operations of the System but essentially I find very little difference in all the replies on fundamentals. There is a general recognition of the need for a mechanism of this kind to perform substantially the functions and to render the services that this System now furnishes. If the Congress were to do away with the present system some other way would have to be found to perform its function and to play its role in the economy.

Basically, the job of the Federal Reserve System is that of monetary management—to increase the money supply and make it more easily available when there is evidence of weakness in the economy and to reduce the volume of money and make it less easily available when indications show that there is excessive expansion. In other words, it is the business of monetary management to contribute to the broad objectives of steady economic progress which is the ultimate goal of all national policy.

The instruments by which these broad purposes of monetary management are achieved are dealt with in detail in the answers to your questionnaire. How and when and why these instruments have been used is likewise set forth at some length. You will have to judge how wisely or unwisely they have been used in the revealing light of hindsight. You will have to judge whether these instruments can be improved, or others provided. We have called attention to some of the various problems for which perhaps better answers can be found but we are not, as you may have noted, recommending any broad or sweeping changes. The test that I have no doubt you will apply is whether the public interest is well served. I think that, generally speaking, it has been well served by the System.

The System is a unique concept, an ingenious merging of public and private interests in a characteristically democratic institution. The doctrine of the separation of powers, as Mr. Justice Brandeis once pointed out, was adopted "not to promote efficiency but to preclude the exercise of arbitrary power." The purpose was "not to avoid friction, but by means of the inevitable friction incident to the distribution of the Government powers among three departments, to save the people from autocracy." Doubtless this reserve banking mechanism could be more efficiently devised or differently organized in the governmental structure but it would be at the cost, I think, of something far more important. In any case, such an institution will in the last analysis render good or bad public service depending upon the abilities of the human beings engaged in its operation rather than upon its organizational form and structure. And by the same token, the resolution of difficult problems and of conflicts of opinion must come out of the minds of men and not from the forms in which they chance to be organized.

I have sought to indicate in a general way the attitude with which we have approached this important inquiry into the public's business as discharged by the Federal Reserve System. We have looked at this System, not as if we had a clean sheet of paper to write upon, but in the light of the concepts on which it was based and its performance over the years. We have tried to be honest with you and ourselves. Certainly we have nothing to withhold or conceal. The record is an open book.

We have sought to make clear that monetary policy cannot, by itself, achieve stable economic progress but that it is an indispensable means to that end. It must go hand in hand with fiscal policy and debt management.

We have tried also to spell out as plainly as we can the meaning of the accord which we reached with the Treasury last March, in which you are naturally interested. Its achievement illustrates the point which I mentioned before that the solution of difficult problems and the reconciliation of differing viewpoints depends upon the ability of men to come to a meeting of minds in the best interest of the public rather than upon the forms of institutional organization. That accord was not a transitory or empty gesture. It is a reality under which debt management and monetary policy are moving together toward the same objec-

tives with mutual understanding and meeting of minds.

May I add that I concur fully in your Chairman's confident prediction that the fundamental issues with which the Committee is concerned "will be found vastly too complex to permit of facile generalization."

I think it may prove useful to the members of the Committee for me to present a summary which I have prepared of our replies to your questionnaire.

SUMMARY OF REPLIES BY THE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM TO THE QUESTIONNAIRE ON GENERAL CREDIT CONTROL AND DEBT MANAGEMENT

This summary presents first the major points of reserve banking philosophy developed in the answers, second, some of the more important positions taken on the issues raised, and, third, several general points as to changes in banking structure and as to foreign monetary organization and experience. Each reply submitted undertakes to deal with the question asked on its own merits and to provide a direct, objective, and comprehensive answer.

Reserve banking philosophy. The following views are expressed with respect to the role of credit and monetary policy and the organization within the Government for such policy.

1) Flexible credit and monetary policy, *together with* flexible debt management policy and an adequate fiscal program, is essential to economic stability.

2) The established relationship of the Federal Reserve Board of Governors to other branches of the Government is consistent with and adequate for the function which the Reserve System performs.

3) The status of the Board as an independent establishment of the Government is sound on the basis of accepted principles of democratic governmental organization, regardless of any theoretical question as to the branch of the Government in which it falls.

4) Changes in money market conditions and in interest rates reflect the interplay of basic forces of supply and demand for short- and long-term credit. Supply is made up of new individual and corporate savings, accumulated cash balances offered for investment, repayments on past loans, and credit expansion by the commercial banking system. Demands from business enterprises, farmers, consumers, State, local, and foreign governments, and the Federal Government form the major components of credit demand.

5) Credit and monetary policy operates primarily through its effects on the availability and supply of credit; it cuts out of the market or brings into it fringe credit demands.

6) In this process, credit and monetary policy affects, but does not determine, interest rates in the market. Interest rates are prices which perform vital economic functions and they should be responsive to basic supply and demand conditions. In a rich, high savings economy with well integrated financial markets, significant changes in the availability of credit, and hence in the volume of spending, need be accompanied by only small changes in the cost of money.

7) On balance the System, through its support of Government security prices, accentuated postwar inflationary pressures.

8) In early postwar years, the System favored and defended a support program as a part of transitional adjustment and sought other means of restraining inflationary credit expansion. This policy took account of the need for time to develop a debt management program that would lodge a greater proportion of the public debt permanently in the hands of nonbank investors. As time passed and the System's support policy led to increasing monetization of the public debt, the Federal Reserve became more and more concerned about the contribution of its operations to inflationary pressures.

9) More flexible credit and monetary policies, applied through the discount and open market mechanism within the framework of an orderly Government securities market, have demonstrated their effectiveness since they were undertaken in March of 1951.

10) In addition to measures affecting credit generally, flexible credit and monetary policy includes the use, on occasion, of selective credit regulations (relating to stock market, consumer, and real estate credit) as well as of voluntary measures.

11) Credit and monetary policy cannot be fully effective without public understanding and support. The System strives to keep the public fully informed on all credit and monetary developments.

Major positions. Of the specific positions brought out in the answers to different questions, the following are the more important.

1) The Federal Reserve Board is subject to the

Employment Act of 1946. Fairly interpreted, the Congressional directive stated in this Act implies a goal of monetary stability and needs no modification.

2) Existing Congressional directives to the Federal Reserve System afford a broad workable guide for policies and operations.

3) The status of the Board as an independent establishment of the Government, subject to the direction and scrutiny of the Congress, should be preserved. Budgetary discretion is essential to maintain the basic character of the Reserve System.

4) No legislation is required with respect to the organizational relationship between the Treasury and the Federal Reserve or the Executive and the Federal Reserve.

5) Advantages of the existing regional status and organization of the twelve Federal Reserve Banks far outweigh disadvantages.

6) Considering the functions in Government of the Federal Reserve Board, a board type of organization may be preferable to a single governor type. The weight of advantage may lie, however, with a smaller-size board—say five men.

7) No substantial gain in efficiency of Federal Reserve decision-making would be likely from centralizing the authority for all credit instruments in one body, the Board or the Federal Open Market Committee.

8) Member bank borrowing at the Federal Reserve should be the principal means of obtaining additional bank reserves. Discount rate changes and open market operations should be the main instruments through which credit and monetary policies are adapted to changing conditions in the economy. This means increased use of the discount mechanism, increased importance of discount rates in comparison with credit policy experience of the past decade, and reliance on open market operations to reinforce discount policy.

9) The present organization for the execution of open market operations is designed to protect the public interest. The Federal Open Market Committee is constantly studying this organization with a view to making adaptations which will improve it. (Open Market Committee questions.)

10) Open market operations should be conducted impersonally without resort to moral suasion. (Open Market Committee questions.)

11) Only in exceptional circumstances should use be made of authority to change reserve requirements, which is a blunt and inflexible instrument.

12) The existing structure of reserve requirements could be modernized in some respects for purposes of more efficient and equitable administration. Also, standard legal reserve requirements could be applied to all banks without raising the question of the dual banking system, the preservation of which the Board favors. This is not an urgent problem at the present time, however.

13) Extension of selective credit regulation to areas other than stock market, consumer, and real estate credit is not feasible. Further experience with regulation in both the consumer and the real estate credit areas is needed to determine their role on a long-run basis.

14) With effectiveness of discount policy and open market operations reestablished, disadvantages of supplementary reserve proposals outweigh advantages.

15) Direct control or rationing of bank credit by the Federal Reserve or any Government agency should not be resorted to except in an extreme emergency.

General points. Several general points in the replies are of interest. These include:

1) Generally speaking, the banking system has kept pace with both the growing and changing credit needs of the different segments of the economy. Today, business, agriculture, and consumers are more adequately supplied with banking services of various kinds than they were 25 years ago.

2) Commercial banks are meeting short- and intermediate-term credit needs of small businesses reasonably satisfactorily. Provision of special long-term credit assistance in this area, such as would be authorized by bills introduced in recent years, namely, Government guarantee of loans made by private financing institutions or the establishment of special investment companies, would be untimely in an inflationary period.

3) Foreign experience with central banking and monetary policy does not yield lessons that are directly applicable to the United States. The following foreign developments are nevertheless suggestive: (a) It has been widely recognized, at least in the countries of the free world, that the central bank should have a large measure of independence within the governmental structure. (b) In a number of foreign countries, postwar credit policy was first operated mainly through selective regulations, but subsequently such regulations have been supplemented or replaced by measures of general credit policy, such as reserve requirements and discount rate changes.