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Remarks by

Wm. McC. Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

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## BASIC RESEARCH AND FINANCIAL PROCESSES

Time passes swiftly. It is now nearly seven years since the Treasury-Federal Reserve Accord. The insurance industry was most helpful in the effectuation of that Accord--notably through its participation in the exchange operation of the long-term 2-1/2s for the 2-3/4 per cent convertibles. This is my first opportunity to express to you my personal appreciation for that public-spirited action, for, without the cooperation of your industry, the successful achievement of the first steps under the Accord could not have been accomplished.

Anyone seriously interested in learning about our economic and financial processes can benefit greatly by meeting with the members of this Association. It is an especial privilege for me to meet with you, for the longer I am in this field the more I find I have to learn about it.

Perhaps all of us need to know more about it, and therefore my theme today is going to be the importance of basic economic research. But, first, I wish to make a few comments about the current scene, and the Federal Reserve's place in it.

Over the last month, the Boards of Directors of the twelve Federal Reserve Banks, with the approval of the Board of Governors, have reduced their discount rates from 3-1/2 per cent to 3 per cent, restoring the level that prevailed before the middle of last August.

A few days ago the Chairman of one of those Boards of Directors-- who is a very good businessman--told me someone had asked him, "What caused the Federal Reserve to reduce its discount rate?" He added that he had been able to give a complete reply in just four words: "The economy. It changed."

If I were to talk about it for hours--which you will be relieved to know I am NOT going to do--I doubt if I could tell it any better, and certainly I could not explain it any more clearly or truthfully than that.

Indeed, it has seemed to me all along that the initial rate reduction action, announced by the Reserve Board on November 14, constituted a straightforward, clear signal that, in our judgment, inflationary pressures were abating, at least for the moment. The action recognized primarily a decline in the demand for bank credit which began to appear most clearly in the early part of September, and has more or less continued to the present time. This represented an important shift from the overwhelming demand for credit--tantamount to a California gold rush, as I frequently described it--which had occurred with amazing persistence over the past two years.

In accord with a flexible policy designed to lean against the wind whenever it is clear in which direction the wind is blowing, the rate reduction appeared to us as appropriate and imperative in the execution of a continuing policy directed toward fostering economic balance. Such a continuing policy evolves over time and depends essentially on basic

business conditions. These conditions may be influenced but certainly cannot be made by money or credit policy. The signal to which I have referred should not be interpreted outside of this context, nor should future actions be predicated upon it. It is not my purpose today to forecast in any way what future action will or will not be taken.

The purpose of Federal Reserve actions should always be to adapt our operations in the most effective way we can devise to promote growth and stability in the economy. Adjustments must be made constantly to attune these actions to business conditions as they develop and progress. So much for our current situation. And the evaluation and judgment of these business developments leads me to want to discuss with you this morning, in brief fashion, basic research and the financial processes.

A major liaison between your industry and the Federal Reserve System has been your Association's research program. Your program seven years ago was in its pioneering stages; now it has reached full maturity. Your leaders showed the greatest foresight in establishing that program, and they are to be warmly commended for its initiation.

As I have watched it develop, I have been particularly impressed by the wisdom shown in providing that it should comprise an appropriate blend of applied research and basic research--that is to say, of research obviously calculated to serve the managerial and administrative interests of the industry and research concerned with fundamental financial processes whose objective is merely to add to the sum total of knowledge about these processes.

There were some of your industry, I am sure, who viewed with misgivings the first major piece of basic research which you authorized--namely, the study of the meaning and measurements of savings from a national point of view. The only purpose to be served by the inquiry from the industry's point of view was to broaden the public's perspective on, and deepen its understanding of, the savings process. Little was it suspected at the time that the work was initiated that economy's major financial problem within a decade would become an insufficiency of savings in relationship to financing demands. Few of you realized that the development of constructive lines of public and private action for meeting this problem would require the results of this study as a primary source of background information and insight.

Many of you are informed that the Federal Reserve System has been requested by the Bureau of the Budget to prepare new estimates of national savings in the light of the findings of this research and to provide such estimates quarterly. This work is now going forward under a special staff and, by another year, the developmental work should be completed and comprehensive savings estimates under Federal Reserve auspices should become regularly available as public information.

It is gratifying to note, from Dr. O'Leary's research report, that the monumental inquiry into national savings was only the beginning of your sponsorship of basic financial research. Your succeeding projects

namely, the studies of Capital Formation and Financing and of the Postwar Capital Markets, look highly promising and the new knowledge gained from them will be helpful to the public generally as well as to the financial community which you represent. As these undertakings are completed, I, for one, hope that the industry will see its way clear to support still others, and that you will vigilantly guard against evolution of your research program towards the strictly utilitarian.

Experience under your own research program demonstrates how knowledge derived from research on fundamental subjects prepares the way for applied or utilitarian research. Your current studies of costs in mortgage lending operations and of life insurance mortgage commitments were originally undertaken as projects to ascertain whether this sort of information could be compiled on an industry basis and what the showing would be if it were compiled. It was an effort to test the limits of the unknowable, which proved its worth and, therefore, is continued for its applied benefits. The Federal Reserve System has found this knowledge particularly helpful and it is appropriate here to express our appreciation to your industry for making it available.

Within the Federal Reserve System, over the years, we have tried to keep alert to a responsibility for basic or fundamental research appropriate to the System's interests. In our research administration we have endeavored, as a goal, to combine necessary day-to-day

observational work on current economic conditions and trends--that is, our applied research--with research activities directed to inquiry whose outcome will merely add to the sum total of knowledge. These activities help to enlarge the minds of those who serve the System and to give them the illumination and insight essential for meeting flexibly and imaginatively the new financial situations which monetary management is constantly encountering.

In the past, these research undertakings have sometimes taken the form of relatively individual inquiries, such as the identification and measurement of factors affecting the money supply and bank reserves; the determination of forces of supply and demand in credit markets; the etching out of patterns of interest rates, in central markets and between different markets; the identification of seasonal forces and patterns in various activities; the measurement of physical production in diverse areas of output by means of index numbers; the sources of cyclical instability in particular fields and in the economy generally; and the nature and measurement of forces of economic growth.

In other instances, the research has assumed a considerable size and involved a coordinated team of workers over a period of time. Illustrations of these larger undertakings in recent years are the System's compilation of a comprehensive historical record for our whole banking system; its development of a system of social accounts to depict the flow of credit and money; its application of the national

survey technique to obtain information about consumer financial positions and about credit purchasers of automobiles; and its more recent endeavor to apply the survey approach to the assembly of information that will show the financial situation of small business, particularly unincorporated business.

We in the Federal Reserve today can take no credit for the tradition of basic research that features the System's program of economic intelligence. The origins of the tradition trace to the climate of enlightenment associated with the System's formative period. We do, however, appreciate its values and we also do what we can to keep the tradition strong and vital. We believe that the dissemination of knowledge gained through research of a fundamental character conducted under Federal Reserve auspices helps to widen the public's understanding of financial processes and, thereby, public understanding of the "systematic reason" of Federal Reserve policies. We further believe that public awareness of the value we place on such knowledge as necessary background for meeting practical problems is a source of public confidence in the System and gives moral strength to System policies.

The Committee for Economic Development has recently announced its sponsorship of a national Commission on Money and Credit to conduct a broad three-year inquiry into the public and private monetary and credit policies of the United States. We in the Federal Reserve System

welcome the undertaking of a new commission, and expect to cooperate fully in furnishing information for its use.

With the changes that have taken place in our financial system over the past five decades, notably in the direction of increasing complexity, there is much unknown that needs to be discovered. One of the major tasks of the new Commission, therefore, will be to develop fresh knowledge. Basic research will be one of its primary tools. The time schedule for the Commission will unfortunately limit the research that can be undertaken under its auspices, and the blueprint which it drafts for a desirable monetary and credit organization in the modern setting will inevitably be deficient by virtue of the still unknown. The Commission, however, can perform an extremely useful public service by recognizing these gaps in knowledge, and indeed by providing an inventory of them. Such an inventory will give fruitful direction to the fundamental financial research undertaken in the future.

In discussion, thus far, I have made a distinction between basic or fundamental research and applied research, and I have illustrated from your research program and from that of the Federal Reserve System what I have in mind by basic research. The implications of fundamental research are subtle and far-reaching, and so are the reasons why it should be valued so highly.

Basic or fundamental research, as I view it, is pursuit of the unknown and the consequent enlargement of the sphere of the known.

Its end is the creative mind, charged with intellectual power to perceive new relations, interactions, and combinations--in short, a mind capable of generating new ideas.

It is out of the cumulative discoveries of fundamental inquiry, sometimes far-fetched or inconsistent with accepted beliefs and often random in the timing of their revelation, that usable knowledge in the end emerges. But the stream of usable knowledge in the shape of tested hypothesis and demonstrated principle cannot be expected to flow in steadily expanding volume unless the springs of useless or disinterested knowledge are constantly feeding the stream at its source. Thus, it may be said that knowledge sought as an end in itself by the free-ranging human intellect, without care for its immediate utility, is incomparably the most useful of humanity's resources.

Basic research in the current climate is too often thought of as a way of gaining knowledge that is uniquely appropriate to the natural sciences; indeed, as a monopoly or quasi-monopoly of these sciences. This limited way of viewing basic research impresses me as being decidedly out of focus. At least, in my conception, it is as applicable to social, political, economic, and financial phenomena as to those of the physical and biological world. And society itself is certainly as delicate a mechanism as a man-made moon, an ICBM, or a biological organism.

To understand the whole of this modern world, we need to view it as a whole. The struggle between the free nations and Russia is only partly military. It is, most importantly, a contest for man's mind, aspirations, and needs, and thus of economic, social, and political systems. We must be prepared to meet the challenge on all fronts, not just on the front of the sciences contributing most directly to military might.

A pertinent question to ask about basic research relates to the elements that make it flourish. An answer to this question will differ, no doubt, from one person to another, and certainly each will answer it according to his experience and education. In all humility, I offer you the points that have struck me as elements as I have pondered the matter against the background of a long experience in coping with research administrators and research budgets in private activity and in Government.

As first and foremost of the elements, I would list disinterestedness of support. Creative minds, informed by self-generating intellectual drives, are required for fundamental inquiry. Experience suggests that such minds, to have full scope for functioning, must be free from the limitations of particular ends, and must feel that they are not "kept" merely for utilitarian purposes.

As a second essential element, basic research would seem to me to be neither empirical primarily nor predominantly abstract in

character. Rather, in its most fruitful form, it combines empirical observation with abstract analysis, so that, on the one hand, observation is imaginatively related to other accumulated knowledge, firmly established or tentatively accepted as a first approximation, and, on the other hand, analysis is disciplined by facts observed from reality.

Thirdly, as an element, and particularly in the social science fields which embrace finance, I would emphasize the role of static and historical description of institutions and processes. The identification and comprehension of institutional functions is as basic an intellectual requirement as there is for these fields, and historical perspective on institutional arrangements and interrelations is clearly compelling for the assessment of institutional change, adaptation, or innovation.

As a fourth element, I would stress the amplex of resources for the support of basic research so that exigent pressures that result in premature findings are kept to a minimum. Premature conclusion of the research inquiry impresses me as a particular bane of social science inquiry. Such inquiry is uniquely tinctured with public interest and we may properly expect its product to work its way eventually into the general stream of knowledge about society. But the product needs to be cultivated to full scholarly maturity for the work to be productively done, and too frequently the product falls short of such maturity.

Finally, there must be the element of dignity for the endeavor and

for the scholar or scholars engaging in the research. We have not given the social science scholar either the emoluments or the honors which are consistent with the importance of his role and which are necessary for attracting to these fields of knowledge the talent that they merit.

Basic research, then, is a far-reaching concept. It has, it seems to me, two major aspects. First, the pursuit of knowledge for its own sake seems to be the condition indispensable in enabling the human mind continually to extend its own reach. Second, fundamental inquiry opens the way to applied knowledge and technology, and the practical benefits gained will be in proportion to the width and depth of that opening. It is particularly gratifying that the insurance industry has recognized the vital importance of such research in the area of financial processes and has sponsored a long-range program consistent with the elements which are requisite to a fruitful contribution.

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