

Address of
Wm. McC. Martin, Jr.
Chairman, Board of Governors of the Federal Reserve System
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OUR AMERICAN ECONOMY: STRENGTH OF THE REPUBLIC

In inviting me to address this golden anniversary meeting of the Economic Club of New York, you are according an honor to the great American institution I am privileged to serve. It is deeply appreciated. Unless the Federal Reserve System has the interest and understanding of organizations such as yours, it cannot hope to fulfill its mission.

In seeking understanding I am not asking approval. It is not idle flattery to say that this is a highly enlightened audience, one unusually well-informed in economic affairs. Yet, I dare say, you are by no means unanimous in your feelings about that misnomer, so-called "tight money." If it gets any tighter, as one commentator has amusingly said, it may be just as hard to get into debt as it is to get out.

I shall touch on that subject later, but an occasion such as this invites a broad look at our economic heritage in order that we may take some bearings on the course we are pursuing.

One of the determinants of that course over the sweep of American history has been the position we as a nation have taken, through our democratic processes, on the role and responsibilities of the Government in economic affairs.

Fifty years ago the United States was just completing its transition from a predominantly agricultural country to the leading manufacturing and industrial nation of the world.

Jefferson's belief that Government is best when it governs least was little by little encroached upon. Yet the system we developed, with its main emphasis on the dignity of man's own initiative and enterprise, spurred the transformation of this country from a wilderness to the world's foremost industrial nation at a speed unprecedented in history.

The system worked. That was proved by the mighty surges of expansion. But progress was not smooth or painless. Prosperity came only in fits and starts. Exhilarating bursts of expansion produced in their wake depressing spells of contraction. Men began to question whether the merriment was worth the misery, especially when the misery was worst among millions who had never gotten in on the merry-making.

Early in the 20th century an event occurred to convert the public's increasingly questioning attitude into a conviction that the Government had a responsibility--a duty--to do something to protect people from economic disasters that were beyond individual control. That event was the Money Panic of 1907. It was into that crisis that the Economic Club of New York was born and out of it that the Federal Reserve System emerged as an institutional response to public demand for the protection I cited.

Diagnosing the panic of 1907 is easy for us now. With the perfect vision of those who look backward in time, we can tonight readily perceive the panic's approach. We know now that the wave of speculative activity that preceded and provoked it was, in fact, unhealthy.

If the vision of the time was blurred, the reason lay, in part, in the widespread belief that a panic like that of 1893 or 1873 could never again occur. How could it, asked a magazine of the day, in view of the "phenomenal increase of our economic strength, the coordination of American industry since 1899, the establishment of the gold standard of currency, and, more particularly, the great and concentrated resources of our banks?"

Certainly most people were caught by surprise when the panic struck. That is evident in a picture of the time, sketched by Senator Nelson W. Aldrich in a speech to members of this club two years later. Senator Aldrich, who headed the National Monetary Commission that was established to study the causes of the financial crisis of 1907, told the members of your club, on November 29, 1909, that "to the great majority of the people of the country the blow came without warning." Most of the economic crises in our history have similarly come--which should teach us to beware of smugness or complacency.

By the time Woodrow Wilson took office as President in 1913, financial reform had become a matter of urgent priority. "It is absolutely imperative," the new President said in a special message he delivered before the Congress of June 23, 1913, "that we should give the businessmen of this country a banking and currency system by means of which they can make use of freedom of enterprise and of individual initiative ... "

Six months later, Congress responded by passing the Act creating the Federal Reserve System, entrusting to it responsibility for managing the money supply of the country. This was a revolutionary step, signifying an end to the historic refusal of the American people to accept the very real hazards of a managed currency.

It was a careful step, too. In framing the Federal Reserve Act, great care was taken to safeguard this money management from improper interference by either private or political interests. That is the importance of maintaining the System's independence. Hence, we have a system of regional banks headed by a coordinating board in Washington intended to have only that degree of centralized authority required to discharge a national policy effectively. This constitutes, as you know, a blending of public and private interests so uniquely American in character.

Since the Federal Reserve System came into being, the country has not suffered from inelasticity of currency and credit, from immobility of bank reserves, or from the money panics that haunted the past. However, we learned from the inflationary bubble following World War I, and the speculative collapse of the late 20's and early 30's, that elimination of these factors of instability did not prevent drastic depression. The over-all problem of stability also involves fiscal, budgetary, and debt management policies as well as prudent decisions on the part of the business and financial community.

In the sphere of business and economics, the great challenge of our times is to prevent the recurrence of the boom and crash sequence that has imperiled us in the past, and could destroy us in the future. It is a continuing challenge. Meeting it requires constant vigilance.

Over the last hundred years the American economy has experienced some 24 full turns of the business cycle, an average of one complete rise-and-fall each four years. As a general rule, the immediate impetus to expansion of the Government's role in economic affairs has come from one of these periodic disasters. But sometimes, it appears, we can be driven as hard by fear of disaster as by disaster itself. To find an example, we need go back little more than a decade, to the enactment of the Employment Act of 1946.

In that instance, so great were the psychological scars of the 1930's that the fear that mass unemployment would develop in the wake of World War II was sufficient--though the fear proved groundless--to bring about the Employment Act of 1946, pledging the Federal Government to do its utmost to keep employment, production, and purchasing power at consistently high levels.

In 1945, as all of us in this audience will recall, there was great apprehension that the problem we were going to face, when the war was over and when millions of men took off their uniforms, would be unemployment on a huge scale, and on all sides, because private business would be unequal to providing jobs for these men.

The same apprehension pervaded Congressional debate on the Employment Act in 1946. The Act was adopted almost unanimously amidst a virtual unity of opinion that it would be necessary for the Government to act to create jobs and to see that the transition from military to civilian employment would not be attended by unemployment on the scale suffered in the depression.

Actually, the history of the period since the war has made clear that the problem has not been one of creating jobs. The ingredients for growth, the technological advances, the opportunities for development in the entire Western world, in the period since the war, have been limitless--and in my judgment still are. The real problem has been sustaining jobs, and holding back inflation that would endanger those jobs by undermining stability.

Nearly everyone subscribes to the objectives of the Employment Act, but it does seem that we need to give more attention to certain related questions: What is the means of attaining high levels of employment? What is the means of sustaining jobs and leading us to a permanently higher standard of living?

In public discussion in connection with the Employment Act, you find many references to money as a medium of exchange, but almost none with respect to money as a standard of value. The reason is that almost all attention was focussed on the problem of deflation, and almost none on inflation.

In my judgment, the objectives of the Employment Act of 1946, under present conditions, can be attained only by understanding inflation and resisting it. The fight against deflation begins with the

fight against inflation. If inflation is allowed to pursue its course, it feeds upon itself in such a way that, when the inevitable correction finally comes, unemployment will be that much worse.

It should not be difficult to see how inflation leads to unemployment. The danger becomes manifest when, as costs go up, it becomes increasingly hard to pass those costs along to the customer in the form of price increases, and it becomes increasingly easy to misjudge or miscalculate the market. Then, the first time volume dips there is a price-profit squeeze and, at some point, the profit squeeze leads to a cutback in investment, income and production. The cutback in production leads to a cutback in employment.

That's the cycle. It is what follows when people try to spend more than they have to obtain more goods and services than are currently available. The situation can't be cured by additions to the money supply. More money only pushes up prices, and speeds the cyclical effect.

I have less faith in the magic of money and credit than some people, and more faith in the economy than those same people when it comes to recognizing the economy's capacity for adjustment. In the last ten years we have consistently tended to under-estimate the vitality and strength of our economy.

Not long ago an economic historian, Robert Heilbroner, declared that man has found, over the centuries, only three ways of insuring the execution of the thousands of intertwined tasks--the disagreeable ones as well as the pleasant ones--that must be done each day to keep human society from breaking down.

One way has been to organize society around the forces of tradition, by handing down the varied and necessary tasks from generation to generation according to custom and usage; son follows father, and a pattern is preserved. Thus, in India, until recently, certain occupations were traditionally assigned by caste.

The second way, also in use for countless centuries, has been to use the lash of central authoritarian rule to see that the necessary tasks get done. That was the system used to build the pyramids of ancient Egypt. It is the system the Soviet government uses today to get its Five Year Plans carried out.

The third solution to the problem of economic survival is the market system. It achieved general acceptance only a couple of centuries ago, and yet it revolutionized civilization in the Western world.

A market provides a means of exchanging goods, but a market system does considerably more. It provides a mechanism for sustaining and maintaining an entire society. It constitutes a way of life that affords freedom that cannot exist in a society run by tradition or the rule of authority. For, in the market system, the lure of gain, not the pull of tradition nor the whip of authority, steers each man to his task. And yet, although each may go wherever he thinks fortune beckons, the interplay of one man in competition with another results in the necessary tasks of society getting done.

Now we know from our experience that the functioning of markets is not always good. Markets can, in fact, function very badly,

particularly when they are dominated by monopoly, by speculative excesses, or by inflationary forces. Those of us who are truly concerned with utilizing the resources of the market must devote our energies to the promotion of competition, the restraint of speculative excess, and the maintenance of the stability of the dollar.

It seems obvious that the market system could not function without money, for money is at the heart and center of a flexible society. No modern country can have stability and progress without some basis of sound currency. That is why all modern countries have central banks. That is why the United States has the Federal Reserve System.

Money performs a great many services for mankind, but none more important than in providing a degree of freedom that man could not attain if money did not exist. The bonds of serfdom that once bound the mass of men for life to their native plot of soil and their native status in society were broken when payment in produce was supplanted by payment in cash.

Money gave men freedom of movement and leisure. It gave them the ability to change the nature and locality of their possessions and earnings at will. It gave them freedom to do as they please with the product of their labors--to eat it or drink it, to give it to a church or charity, or spend it for learning something, to save its value against some unforeseen event, to use it to lift living standards for themselves and their families, or to put it aside to fortify their independence when they wish to assert it.

In short, money can be an instrument of freedom--if only we permit it to function in that role. But the power over money can also be an instrument of tyranny--witness the coin clipping by kings, a form of tyranny known at first hand by many of those who settled early in America. That is one of the reasons why there has been so much concern over monetary policy and monetary actions throughout our history.

When the first Bank of the United States was established under Government charter, great effort was put into preventing the Government, or political authority, from having any say over the bank and thus having a chance to indulge in coin clipping.

Gradually, as time went on, apprehension arose about too much private control over money. When the Second Bank of the United States was formed, there was some recognition that the public interest should be represented in the bank's set-up. So, the Congress made provision for public representation when it granted the bank's charter.

But to Andrew Jackson, and many others as well, it seemed that the public representation permitted was not enough. It was not that Jackson opposed the idea of any central bank, for he said in his veto message that such an institution "is in many respects convenient for the Government and useful to the people." What he objected to was that this particular bank, as it was set up, provided private interests with what was, in the words of his veto message, "a monopoly--an exclusive privilege of banking...granted at the expense of the public." In consequence, Jackson destroyed the bank.

The enactment of the Federal Reserve Act, as part of Woodrow Wilson's "New Freedom," marked the beginning of what we might call modern times with respect to the role of Government in monetary affairs. Jackson's complaint had been answered: there would not be private domination of money--nor political domination either.

Let us not, however, be misled into thinking that the entrustment of money management to the Federal Reserve represents a change in fundamentals or an unawareness of the economic facts of life or a denial of the ability and courage of individuals as an essential part of the mechanics by which a higher standard of living is to be achieved.

At the center of our way of life always remains the market place, tying together individual freedom and material progress. While concepts may be modified, and should be from time to time, our basic thinking continues to recognize private property, free competitive enterprise, and the wage and profit motive, operating in the open market through the price mechanism, as the most effective means of developing and sustaining our march toward better living standards and the elimination of poverty.

Nothing in the background or history of the Federal Reserve Act indicates any misunderstanding of the law of supply and demand, or any belief that a Federal Reserve System could control or successfully manipulate, for long, supply and demand forces. Certainly the history of the past 40 years indicates the wisdom of this approach and demonstrates again that you can change the nature of demand and alter the composition of supply, but you can no more abolish the law of supply and demand than you can abolish the law of gravity. It must

be reckoned with always, sooner or later, and whenever we ignore the working of the market we do it at our peril and ultimately must pay the piper.

Six years ago this month a decision to unpeg the Government securities market was in process of being carried into effect. For a number of years, efforts had been made to adjust the supply-demand relationships in Government securities without resorting to the price mechanism.

It had become quite popular in that period to assume that neither interest rates nor exchange rates made any difference, and that notions that they did matter were the fetishes of outmoded classical economists whose views were completely out of tune with the modern, postwar world. Then we saw reality creep up on us, a seller's market change to a buyer's market, and rates could no longer be pegged at artificial levels. The devaluations of the 1949 period, brought to head in September by the readjustment of the British pound sterling, were casting their shadows before and indicating that it might not be long before the supply-demand relationship in our Government securities market would have to be faced squarely unless we were willing to accept the alternative of drastic depreciation of the dollar.

Essentially, the Treasury-Federal Reserve accord returned to the market some of the influence which had been denied it by conscious Government policy for a period of more than 10 years. Once Government securities ceased to be interest-bearing money, and supply-demand relationships began to be equalized by adjustment in interest rates,

the credit mechanism once again began to operate through the market place.

The Federal Reserve System ceased to be an engine of inflation. It would still be that if it were to pour out money in the endless stream that would be necessary to supply reserves in sufficient volume to meet every demand for credit without an increase in interest rates, the price of money.

No one should expect the Federal Reserve to do that, for to do so would be an abandonment of the System's duty to keep the flow of credit in line with the resources of the economy so that we may continue in the path of stability and growth. Neither should anyone fear that credit will become "unavailable at any price." Fundamentally, the so-called "tight money" situation that has evoked so much comment has not been brought about by a reduction in the money supply. The money supply has not in fact been reduced. Actually, the money supply has increased, and so has its velocity or turnover. Credit has not been tightened by an insufficiency of money; rather, the tightening effect has been produced by the magnitude and intensity of demands for credit from practically all quarters. All of the demands could have been satisfied only by creation of more bank credit--creation of more money--and that, of course, would be inflationary.

But the problem of achieving a balance is not insoluble. In an economy as strong as ours, it can be solved in large measure by a reduction in spending and an increase in saving brought about by market forces.

The rediscovery of monetary policy in this country and throughout the free world dramatically illustrates the traditionally American

recognition of the superiority of judgments arrived at in the market place to those made by individuals, or groups of individuals, within either Government or private business. It is my conviction that, by and large and excepting periods of war, you will get more impersonal, fairer distribution of our economic production through the process of the market than you will by leaving the distribution to any group of men, whether in the Federal Reserve or elsewhere. Furthermore, the workings of the market will create a greater end product to distribute than any other system as yet devised.

The background of the American Revolution is so well known that every school-boy understands, in an emotional sense if no other, the guarantees of the First Amendment to our Constitution. Freedom of religion, freedom of speech, freedom of the press, freedom of the right to assemble and petition--all of them strike answering chords in the hearts of most Americans. Yet it has also seemed to me that the inter-weaving of these concepts in the fabric of our society, in terms of livelihood, is not so well understood. That is why I have spent so much time--perhaps too much--in reviewing our economic heritage.

We are a Republic, a constitutional democracy in which the general welfare is expressed in political procedures, forms, and institutions. At the base of our structure lie certain principles and concepts, such as the market system, which are themselves the product of an evolutionary process.

In discussing these matters with you tonight, I have been motivated by conviction that the problems we are dealing with today, and the road we hope to travel tomorrow, must be related to these principles and concepts if we are to have useful guideposts by which to keep our course steady in the murk and fog that from time to time surround us.

I have a deep and an abiding faith that the foundation on which our American economy rests is firm and sure. Our American economy is, indeed, the strength of our Republic.

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