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Reminiscences and Reflections

From the remarks of
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Chairman, Board of Governors of the Federal Reserve System,
before
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This will be my last appearance before this group as chairman of the Board of Governors of the Federal Reserve System. As many of you are aware, my term of office expires next January 31 and I must confess that I'm looking forward to that day.

My first attendance at a Business Advisory Council meeting goes back to December 1945. That was just a few months after the end of World War II and almost a quarter of a century ago. A lot of us who were then in our late thirties were happy to read a book advising that "Life Begins at Forty."

I've attended many more meetings of The Business Council over the years since, and I've always enjoyed them. The frank exchange of views that has marked these conferences has been both enlightening and useful. I have found them extremely interesting meetings.

I might say that I have found my more than 18 years as chairman of the Federal Reserve Board an extremely interesting experience also. These years have been some of the most absorbing in our nation's history. And, ironically, my term as chairman is ending on a note reminiscent of its beginning. It began with a mighty effort by the Federal Reserve to control the inflation that accompanied the Korean conflict. It is ending with another mighty effort--against the background of another land war in Asia--to control the current inflation and expectations of further inflation.

We all have a tendency to say that present times are the most difficult that the country has ever seen. It seems to me we

are always in difficult times. Indeed, I can hardly remember when, in the last four decades, you couldn't have gotten up and said, amid widespread agreement, that "these are the most difficult times we have had." Chances are it has always been like that.

I remember the day in September 1931 when England went off the gold standard--a memory made vivid for me by the fact that I had just gone on the floor of the Stock Exchange. A couple of years later, in the long aftermath of that event, President Roosevelt would be working hard to keep prices from falling further. Today, it's just the reverse, and President Nixon is working away at keeping prices from rising further.

I remember, too, the day in December 1941 when we were plunged into World War II--by that time, I was already in the Army--and the Federal Reserve joined in the war effort by adopting a policy of pegging the prices of Government bonds.

By that means, the Federal Reserve saw to it that the banking system was supplied with lendable reserves ample enough to provide the Government with the war financing funds that it could not raise through taxation and through borrowing people's savings.

It did so by buying outstanding Government securities on a huge scale. The Federal Reserve's payments for these securities wound up in bank reserves. In turn, the banking system used these additional reserves to purchase new securities that the Treasury was issuing to finance the war effort.

To keep the process going, the Federal Reserve in effect maintained a standing offer to buy Government securities in unlimited amount at relatively fixed prices, set high enough to assure that their yields would remain at predetermined low levels--which, for 90-day Treasury bills, meant $3/8$ of 1 per cent. When no one else would buy the Government's securities at the prices that went with that, the Federal Reserve did so. And in so doing, it financed the war.

The process was successful for its emergency purpose. But the procedure of pegging Government securities at high prices and low yields entailed a price of its own that the economy--the people and the Government alike--would later have to pay. The results were two-fold:

1. The market for Government securities became artificial. The price risks normally borne by participants in that market were eliminated: bonds not payable for 20 years or more became the equivalent of interest-bearing cash since they could be turned into cash at par value--at any time--at the option of the owners.

2. Money was created rapidly and continually, in effect setting a time bomb for an ultimate inflationary explosion. For a while, the immediate consequences were held down more or less by a system of direct control over prices, wages, manpower, materials and consumer goods. But eventually, the explosion occurred. And finally, in 1950, the outbreak of hostilities in Korea and the inflation crisis that accompanied it brought matters to a head, setting the stage for the Treasury-Federal Reserve Accord that was to put an end to the

price-pegging practice, make it possible to regain effective control over the creation of new money, and open the way to restoring financial stability in the decade of the 1950's.

I remember the day the Accord came into being--March 4, 1951--a memory heightened by the fact that by then I was in the Treasury and, as an Assistant Secretary there, had participated in negotiating the arrangements that enabled the achievement of the Accord by providing a means for safeguarding the market and the economy against the threat that enormous holdings of Government securities would be dumped.

It may seem strange now that the practice of pegging Government security prices remained in effect for nearly ten years, most of them after the end of the war that had prompted its adoption. But discontinuance was slow in coming, largely because of fear that, without Federal Reserve support, the market would collapse.

Let me acknowledge that I was terribly worried myself when President Truman asked me, at about that time, to take the chairmanship of the Federal Reserve. I am a great admirer of President Truman, but I don't think he and I had the same understanding of the market process. I had a talk with him, telling him why I didn't think we could prop Government bond prices further at prevailing prices, and why I thought the country couldn't afford the monetary results of trying to do it.

The President was very patient with me. He explained to me very nicely how in World War I he had bought some Liberty Bonds

and they went down to 82, and he said: "You wouldn't ever let that happen again, would you?" I said, "Mr. President, I don't want that to happen again, but it is more important to maintain fiscal and monetary responsibility, and maintaining it may mean there is no way to avoid something like that." And I made to him for the first time an observation that some of you have heard me use on a number of occasions since: that markets will not wait upon kings, prime ministers, presidents, secretaries of the Treasury--or chairmen of the Federal Reserve Board.

Then President Truman said maybe he didn't understand market processes fully, and all he wanted from me was assurance that--whatever might happen--"you'll do the best that you can." So I said yes, Mr. President, I'll do the best I can, but if the prices of the Government's securities are to stay up, you'll have to help on budgetary and fiscal policy.

So we went ahead and unpegged the Government securities market, and after a while Government bond prices did drop. Then the press went to the President--by now, the bonds were down to 97-1/2--and they asked: What happened to your man Martin? What's he doing? And President Truman was wonderful. He said, "He's doing the best he can."

Well, that's about what I've been doing ever since, and I wouldn't want to claim much for it. I think the other Presidents besides Mr. Truman with whom I've served--Messrs. Eisenhower, Kennedy, Johnson

and Nixon--have also been generous in recognizing that my efforts have been genuine and undertaken in good faith, even though we haven't always agreed on everything. For my part, I can truthfully say I've enjoyed working with them all, and I am completely convinced that each in his way has sought earnestly to do the very best that he could for his country.

Over these years, our economy--and the standard of living of our people as a whole--have made sizable gains. In the last couple of decades alone, the gross national product has increased almost three-fold, and so has personal income. The number of jobs has risen from about 60 million in 1951 to about 78 million today and, though ours has increasingly become more an economy of services than of manufacturing, the index of industrial production has doubled over those years.

This has not been an unbroken rise, nor have these been untroubled years. We have been buffeted by inflation in much of this time, but we have been buffeted by deflation also for briefer periods. And we have enjoyed, in the first half of the 1960's, at least one prolonged spell of relatively steady prices and vigorous economic growth, after laying the base for it when the back of another dangerous period of inflation--and mounting expectations of continued inflation--was broken in the late 1950's.

I've mentioned days in 1931, 1941, and 1951, so I'll mention just one more in a period closer to the present--in December 1965--when we raised the discount rate. The raise was only from 4 to 4-1/2 per cent, which seems like a bargain basement rate these days,

but it won me a trip to Texas for a chat with another President. Now let me say that I enjoyed President Johnson, and that occasion was no exception. I had come to know him quite well in 1964, and we got along very well because--like any other Presidents I've known--he was totally frank with me, and I with him.

Early in his Administration, we had a good talk in which he told me he came from a part of the country that liked low interest rates, and he thought that's the way interest rates should be--low.

Well, that wasn't exactly the point of difference between us: it was more subtle than that. I, too, like to see interest rates as low as conditions of inflation, deflation, or stability (which is my preference) permit them to be. But President Johnson liked them to be low--all the time. And he told me so, freely and frankly.

So I said, Mr. President, I want to tell you how you can have low interest rates, and the only way you can have low interest rates. It is with budgetary responsibility, both in respect to Government spending and taxing, and a fiscal policy that makes that responsibility plain. If you will see to that, you can have moderate interest rates--maybe not as low as Mr. Patman likes, but you can have them low. And I want to add right now that I still think we could, and can, have them that way, on that basis.

But that, of course, wasn't the way things went. The war in Vietnam began to escalate sharply around mid-1965, when we were also embarking on many new, sizable and worthy welfare programs, and

we became increasingly over-committed and over-extended, especially because nothing was being done about taxes even though expenditures were mounting.

I tried to set out that situation to President Johnson in another discussion we had in that period, and to impress on him my belief that we were getting into trouble on the budget, and we were going to have inflationary problems--which of course would bring higher interest rates--if we didn't do something about taxes and expenditures to head off a wage-cost-price spiral. I remember him saying to me, 'Well, yes, I think so too, but we can't do it now. We'd risk overkill.' That was the first time I'd heard that expression used, but I've heard it plenty over the years since, when all the while the economy--and inflationary pressures as well--were burgeoning.

In both economic and financial affairs, we have on several occasions since 1951 come face to face with crisis--which, I hasten to add, is quite different from saying we have actually experienced crises in the shattering sense that word once was understood. We have walked with crisis at our side, and as we look toward the decade just ahead, it seems probable that we shall have crisis as a companion again from time to time as history unfolds.

I like studying history but I happen to be one of those persons who doesn't believe that history repeats itself--and certainly not in an identical pattern. I think there are guides to be found in history, guides to general principles, to general forces, which can be

extremely valuable in meeting new situations. I doubt if any two situations are totally similar. But it does seem to me that we have to keep a perspective of our historic heritage if we want to build.

This country has in fact worked its way up to first rank among nations of the world by a process of evolution rather than revolution, by a step-by-step movement--which is still in progress--toward amplifying the opportunities and increasing the capabilities of the individual, and therefore of the group, and of the nation.

Other countries have staked their destiny upon systems whereby an all-powerful few decide what's best for the many, and then use the whip of governing authority to drive their people to sacrifice their labor and lives in service to a government whose welfare is considered to stand separate from that of the people themselves.

Our country has placed its faith in a completely different way of life. Here we do not believe that the government should control the people, but that the people should control the government. That applies in economic as well as political and personal affairs.

In consequence, the role we have assigned the government in our economic life has been a supplementary rather than a dominant role. For the efficient use of economic resources to bring about a higher standard of life, we have relied mainly upon the enterprise and energy of free people working for better things for themselves, their families, and their communities.

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 ownership of 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 advancing our march toward still better living standards and the elimination of poverty.

Nothing in the background or history of the Federal Reserve Act indicates any misunderstanding by its framers of the laws of supply or 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 years I have touched upon tonight demonstrates that you can change the nature of demand and alter the composition of supply, but you can't abolish the law of supply and demand. That is a law we must reckon with always, for whenever we ignore the working of the market we do so at our peril, and ultimately must pay the piper.

It seems obvious that the market system could not function without money, for money is a core ingredient of a flexible society. No modern country can have stability and sustained growth 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, and why the Federal Reserve is charged with the duty of doing all it can, within its limited powers, to help maintain the dollar's value.

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 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 locale 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 church or charity, or spend it for learning something, or to save its value against some unforeseen event, to use it for improvement of their living conditions, or to put it aside to fortify their independence when they wish to assert it.

In short, money can be an instrument of freedom--"coined freedom," as I once saw it described in Switzerland--but only if we permit it to function in that role by doing the things necessary to protect it in value.

I don't want to overstress one kind of danger, for deflation is dangerous and damaging too. But the fact remains that the great problem that many of us have been grappling with this past year, and I might say for most of the years I've been in the chairman's seat at the Board, has been inflation, or stated the other way, seeking to check deterioration of our currency.

Success in these endeavors has by no means been as great as I would have wished, but I'm glad the efforts were made, and I don't

think we can afford to relax them now--or ever unwarily drop our vigilance. Currently, I believe that we are making progress against the forces that give rise to inflation, and are on the threshold of seeing real results from the anti-inflationary measures we adopted last year and have carried through on this year. And we are also, I think, putting some dents in the inflationary expectations that have motivated many of our businesses and consumers. After several years of rapidly rising prices, it is only natural that many spending decisions would be motivated by the fear that prices will be higher next year, or by the conviction that inflation will bail out even the most marginal undertaking. But there is evidence now, however fragmentary, that these attitudes are changing, however slowly.

There's a phrase much in vogue these days among economy watchers--I'm sure everyone here is familiar with it--about looking beyond the nearby terrain to the other side of the valley. Except for certain connotations that may sometimes be implied about the shape of the slope, I rather like the idea of this long gaze. We're moving into a new decade, and even though too much is probably made of the rather arbitrary boundaries of time imposed by the calendar, it behooves us to look toward the horizon, whether it's the other side of a valley, or something else, perhaps ground much like that we have been traveling.

Now I'm going to remain silent on whether we're entering our symbolic valley at this moment, or beginning to cross the floor--or still traveling on the same old track. I find the chairman of the

Federal Reserve Board can't indulge in this sort of metaphor without upsetting a great many people, and I will happily forego that for the remainder of my term. For the purpose of ending this discussion, I will merely say tonight that there is a far side and we will be there tomorrow or the next day or next year--and we would do well to ask ourselves now what we want to find when we get there, and conduct our affairs accordingly.