PUBLIC FINANCE AND THE PEOPLE'S WELFARE

ADDRESS

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THE HONORABLE W. RANDOLPH BURGESS
Deputy to the Secretary of the Treasury
of the
UNITED STATES OF AMERICA

before the

NATIONAL BOARD OF FIRE UNDERWRITERS

MAY 20, 1954
Hotel Commodore
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Some years ago the British Ambassador, Oliver Franks, in one of the philosophical talks, at which he was particularly good, developed the idea that the most important single thing for the happiness of any person was to have somehow a sense of belonging, of belonging to a group, to a family, or to a country.

I have been thinking as I sat here of how that is true of me tonight. You have made me feel with your welcome a sense of belonging. I was one of you for many years. I had to cut that connection to go down to Washington, but I have a feeling here that you are people that I know, and in a sense I am coming back home to tell you what has happened to me in the past sixteen months in Washington.

It is sixteen months since the Eisenhower Administration came in. At that time the General, beloved by all the people, started in with a set of principles—some good old-fashioned principles from the Midwest. [Applause] Today his Administration has a program to carry those principles into effect. I do not believe that there ever was a legislative program presented to the Congress that had the care and preparation that the present program now before the Congress had. In every field it was the result of a year's work with as competent people as the General could assemble, and with advisory committees from civil life. You all know about them. I think some of you have participated in them—such as the Housing Advisory Committee. In our Department, the Treasury, we worked for a year with men from many, many business groups to analyze what tax changes should be made. You all know the work of the Randall Commission in examining the economic phases of our foreign policy, the enormous amount of work that was done under the leadership of that extraordinarily competent man, Clarence Randall from Chicago.

It was a fine program. I believe much of it will be carried into effect by the present Congress. I wish more of it could be and there were not quite so many—shall I say—using a French word—divertissements. But I still have faith that the Congress will carry out in this session a great many of these programs and that what they don't do this time they will have a chance to do another time.

President Eisenhower has stated that his program was, in economic affairs, conservative; in human affairs, liberal. I believe there is no contradiction between those two terms. For human welfare a conservative economic program is as effective as anything that is labeled "something for humanity."

That brings me to the Treasury program. You may not think of that as a humanitarian program, but in my book it is. The Treasury program is a simple one. We have three points we are working for. One is economy. The second is lower taxes. The third is honest money. I do not believe that people generally realize the extent to which those programs already have been put into effect. Let me run over them very briefly. I will try to do it in just two or three figures.

In the economy program, if you compare the Truman budget for the present year with the budget which we have put up to the Congress for next year, there is a cut of 12 billion dollars. [Applause] Seven of it is this year, and five next year. That is the cut from what would have happened. Let me assure you that that curve that we are working on was on its way up further. The first thing we had to do was to bend the curve over, and then to cut it down.

That cut, of course, has had an effect upon the economy, when you cut that much spending, both actually and in anticipation. There are two limits on the speed with which you can cut expenditures. One limit is the defense program. I know we all agree that America must keep its defenses strong. It is the only deterrent, the only sound deterrent, to wars in the peculiar kind of world we live in today. The second limit is that if you cut too fast, you upset the business machine to a point where it may lose its equilibrium.

The second point, lower taxes—and that carries on from the point of not upsetting the machine—if the President's program is carried into effect for taxes, it will mean a cut in taxes this year of $7,400,000,000. Five of that went into effect the first of this year—the cut in individual taxes, the cut in excess profits taxes. The excise tax cut of 1 billion dollars has gone into effect and the tax reform measure is being worked on today; and all this totals 7.4 billion dollars, which is the largest dollar cut in taxes ever made in this country—or, so far as I know, in any country—in a single year. Two-thirds of that reduction is directly for individuals. One-third is to favor production to make more jobs and a higher standard of living.

I would like to say a word about the tax reform measure which is now before the Congress. The measure, as I have indicated, was the result of many months of work by as competent a tax staff as we could assemble, working closely with the committees of the Congress. They were aided by committees from the different industries who gave advice on different points. It was in effect the first rewriting of our tax laws since 1876. It has been corrected at point after point to ease the burdens which are unfair, to help out individuals, to make a beginning of better tax laws for the stimulation of business. This latter includes the beginning of some reduction of double taxation of dividends and then a change in the depreciation law to provide for much more rapid depreciation on a curve rather than on a straight line. That bill contained undoubtedly, as it passed the House, some things that needed correction. The Senate committee is working at that. There are some changes being made. I hope it will come out of the Senate committee in a form that all of you will feel you can support. There may be some things which go through this time which will need later changes. When you make a big change of that sort, you cannot be sure that you have caught everything until it goes into effect. But we believe that this tax reform is a measure long overdue. It contains most of the changes that have been recommended by tax students for many years. It is at least a beginning on them. We could not afford to go very far with it, but it follows the principle of making a little start at a big problem.

Now the hassle in the Congress has been whether you should take this tax reform bill or whether you should raise the exemptions for individuals. I think we are going to win the day on that and get the tax reform bill instead of the other. One reason for turning down the raising of exemptions is that we simply cannot afford it. The raising of $100 in exemptions would cost practically 2.4 billion dollars. Some people say, "Well, why not omit the provision about the dividends and put in this increase in exemptions?" The dividends adjustment costs 240 million. The other change would cost 2 billion 400 million. The two things are completely incommensurable in terms of size.

The reform tax bill will be largely offset by continuation of the corporate levy at 52 per cent for the time being. It seems to us more important to get on to the basic provisions, even though we had to continue the corporate levy at its present level for a while yet.

We believe also that this reform bill, while primarily reform, will help out in the present business transition.

So much for those two points of economy and lower taxes. The third point is honest money, money that will keep its value over a period so that the person who saves money, the person who buys life insurance, the person who puts away his money, the person who retires on a pension, will find, when he spends his money, that it has not lost a large percentage of its value. The first requirement for honest money is a budget under control so you do not keep spending a lot more than you take in. The second requirement for honest money is to have a freer market for government securities rather than a pegged market. The only way you can peg the prices of government securities is by pouring out more and more money, which is directly inflationary.

The third point is to free the Federal Reserve System from political bonds which have bound it for many years and kept it from doing its task for the welfare of the people. The Federal Reserve partly regained its freedom in 1951. It has now completely regained that freedom, and over the past sixteen months has been able to exercise its powers to modify these business swings that we are in the midst of.

The fourth point is to try to deal with the public debt, that 270-billion-dollar monster that has fastened itself on us, in such a way as to neutralize its inflationary effects or its deflationary effects from time to time. Of course, in general what you want to do is to try to spread the debt among the people rather than have it concentrated in the hands of the banks and in short-term securities. That is a big job. We made a start at it. We have made just a start. This payroll savings plan is just one of the ways. Another way is the sale of bonds on the market. We made a start on that and had various adventures in doing it, but we are going to keep on at it until we get it further along.

Those are the major points of the program that we are trying to carry out. Those are the facts of it. I want to say just a few words about the philosophy of it. What is the reason for it all? What does it add up to?

To my mind this program of cutting the costs of government and lowering taxes, of giving us sound money, means just one major thing. It means greater freedom for the people. It means removing handicaps to long-term economic progress of this country. It means better jobs and a higher standard of living, for progress in this country depends on what the people do—and not only on what the government does. The job of the government is to clear the way so the people can go ahead and raise their standard of living.

Now what are the great enemies of progress? If you had to tick them off on your fingers, what are the great enemies of human progress—outside of war? War is the worst enemy. In my book—and I think in yours—too much government is one of the enemies of human progress. Too many controls—one of the first things we did was to abolish the price and wage controls. Too high taxes—we now know how on every hand taxes tend to stifle initiative and tend to retard the rate of progress. Too much government spending that interferes with the normal processes of the economy—again I say, it is the people of the country who make progress, not the government. The job of government is to release the energies of the people. [Applause]

What would you say if you had to pick the next enemy of progress? I would say, inflation and deflation. We have had plenty of experience with those in this country within our memory. There was the inflation of World War I, the deflation of 1921. There was the inflation of the late twenties and the deflation of the thirties that lasted a number of years. Now we have had the inflation of World War II and of Korea. These were years of inflation that have doubled the price level, doubled the cost of living since 1939. Where do we go from here?

I think we have learned a good deal from the experience of these years. We have learned that in these inflations and deflations what the government does is enormously important, and that wise governmental policies can make a difference.

The first thing to do is to stop the inflation. If you don't stop the inflation, the deflation becomes almost inevitable. I notice that Barney Baruch the other day made a statement about that. He was quoted as saying, "If we want to prevent depressions, we must first learn how to prevent inflation. . . . "

The second job, of course, is, when you have passed the turn, to recognize that recession is with you and then use the powers of government in every appropriate way you can to check it. But the hard part of the job is to act while the *inflation* is on and keep it from going too far. [Applause]

That is the background against which to judge what we and the Reserve System have been trying to do since the beginning of 1953. When we came in, in early 1953, it is perfectly clear to me that we were in the latter stages of the great inflation of the war and Korean period. Inventories were rising—they went up close to 5 billion dollars in the first eight months of 1953. Installment loans were rising—$500,000,000 a month for a-while. We were removing controls, which I think was the right thing to do at that time. That position was perfectly clear. The Reserve System had for months, before we came in last year, been exercising increasing restraint on this situation. Our own policies were to blend our own actions with those of the Reserve System and try to make sure that our debt management policies at that time did not increase the inflationary boom in credit. That was why we sold long bonds, why we joined with the Reserve System in a restraining action.

In the middle of last year the position changed. Business began to fall off a little bit. The Reserve System, I believe, changed its policy and adjusted itself to the new situation as quickly as at any time in the history of central banking. They reduced reserve requirements; they made money more freely available. We adjusted our debt management policies in exactly the same way.

It has been interesting, as you follow the money markets over the recent months, to see the working of the easier money policy. We have been following particularly the mortgage situation and getting reports from all over the country. You can almost see the money finding its way into different parts of the country, and see the discounts on mortgages disappearing as credit became freely available, so that today I think it is fair to say that the 4½ per cent mortgage is prevailingly available throughout the country. There are only a few places where there is still a slight discount. It is a clear case where a money policy has been working directly and obviously.

Another place has been in the new issue market. I do not think people realize the huge volume of new issues that are coming out today. We follow the figures, and it is clear that the total volume of new issues for this year to date is as great as it was in the same period last year when the volume was above all previous records. The corporate issues are a little lower, but the municipal issues are enough larger to make up for them. Those key avenues through which money is pouring out for use through the country are providing a substantial basis for recovery.

To try to summarize where we are now in this situation, I was looking at a few of the figures that came out just the other day which summarized the position for the first quarter. This figure seems to me very significant, that personal disposable income after taxes—that is the amount of money the individual has left after paying his taxes—was 4 billion dollars larger (at the per annum rate) in the first quarter of this year than it was the same time last year. So whatever we have in readjustment is not due to the fact that people do not have the money to spend. The rate of savings is higher, yes, but the rate of personal consumption, personal expenditures, is today 2 billion dollars higher in terms of annual rate than it was a year ago. Government purchases are down. Federal purchases down, state and municipal purchases up, but not enough to make up for the difference.

I summarize by saying that I believe in these sixteen months this country has followed effectively in its monetary and fiscal policies what are sound principles. In the early part of last year restraint was exercised against inflationary influences. The Government turned around quickly as soon as a change in direction of movement in business was clear, I believe the policies since then have been solidly in the right direction.

One alternative, of course, was a policy of extra spending, of throwing the Federal money out as Mr. Truman advocated in his speech the other day. We believe that this situation can be handled largely through monetary and fiscal policies, and that we can come through this adjustment without any serious scars.

It is, however, a period that is putting to the test our private enterprise system. For twenty years we have been living in an inflationary trend, in increasing government expenditure, with the government taking over a steadily larger segment of our economic life. That trend has changed, and some people employed by government directly or indirectly must somehow find jobs through private enterprise. [Applause] That will be the test of whether private enterprise has in these years forgotten how to do its job, or whether it is ready to go ahead and do it.

Chancellor Butler of Great Britain recently used a phrase that I like. He said, "Freedom is a clean wind, but a chilly one." He knew, because when the Conservative Party came to power, they faced a situation something like that which we have been facing in this country. They had had years of a Labour government of the "spend and spend and tax and tax and control and control" school, and the first thing they did when they came in was to put into effect a sound fiscal and monetary policy. They cut the budget so that it was substantially in balance. They raised the discount rate of the Bank of England to 4 per cent. The 2½ per cent "Daltons" put out a few years ago—Dalton was then the Chancellor of the Exchequer—went down to 60. He knew what the chilly wind meant, and the banks and the people in the market in England knew it. But they have gone ahead with this inculcation of freedom. They have reopened the cotton market, the grain market, opened the gold market, and gradually worked to reinstall the methods of freedom. The next problem they face is the problem of making their currency convertible. That is something we all must think about because that is a big leap. I was over there two weeks ago to a meeting of the EPU, the European Payments Union. Everybody was talking about when Europe and England would be ready to make that next step. But the important thing is, they have gone ahead with this new program of freedom. England has picked up and by increased production has raised its standard of living, and has been released from rationing and many controls.

We are going through the same operation exactly, moving from a period of increasing controls, of increasing government spending, to government's drawing back and giving the people of the country and private enterprise a chance to show what they can do, whether enterprise can work together, whether it can fill the gap, or whether we will go back to the system of more and more government.

One test of the country's desires is whether the President's program before Congress, which is an embodiment of the philosophy of more freedom for the people, will have the support of the people and will be carried through. The other test is with enterprise itself, whether this new breath of freedom will prove too chilly, or whether we will go forward with it in the good old American way. My belief is that we will. [The audience arose and applauded.]

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FEDERAL RESERVE AND TREASURY RELATIONS

Mr. President, Ladies and Gentlemen: I was very glad to accept this invitation because it gave me a chance to get back among many old friends and others whose names I have seen signed to interesting articles and are familiar in the field in which I now work. In fact, I felt a little bit like a boy out of school to come here and meet with you. I suppose it was that seductive atmosphere that led me to adopt the title that I have for this talk: the relation of the Reserve System and the Treasury.

A few weeks ago, Emerson Schmidt called my office to find out what the title would be, and I sent back that title. He called back a few minutes later and asked my secretary if she was sure that that was the right title, because that was such a highly controversial subject. I sent back word that that was the right title, and that it was no longer a controversial subject. In fact, if I can give you in tabloid form what I want to say to you, it is exactly that--that the question of the relation of the Treasury and the Reserve System is not now controversial. We are getting along with amity and with understanding, and there is no controversy between the Federal Reserve and the Treasury.

Now, why did I want to talk about that? Well, obviously there has been in this country a considerable misunderstanding about that relationship, and it has appeared in the literature and the discussions of the subject. It has all been lumped together--the hard money policy of the administration, without distinguishing what the functions of the Treasury and the Reserve System were--and more latterly the cynical have said, "Well, they tried the hard money policy and debt funding and just decided that it was more popular to go back to the old New Deal inflationary methods, and so the administration has just turned around and adopted again the old inflationary policies," there again without any appreciation that that was lumping together in one ball of wax a group of ideas and a group of descriptions of action that didn't belong together.

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I am tempted to turn back the pages of history--this will make it very dull for my newspaper friends because there isn't much news in it--and exercise the prerogatives of somebody who has been in this field a long time and ramble around a little bit in that history to try to shed light, if I can, on the relationship of Treasury and Reserve System in the history of the past. And of necessity I have to be a little personal.

The System celebrated forty years since the passing of the legislation last summer and is now celebrating forty years of the life of the System. I have been in very close touch with the System--in it or near it--for thirty-four of those forty years.

Carl Snyder, an old associate of mine in the New York Reserve Bank, used to have a phrase. He said, "To be interesting what you need is an attitude of cheerful garrulity," and I shall try to be cheerful and let you judge whether I am garrulous or not.

The important and interesting thing that I gather from this swing of history is that in the changes in economic fashions--and, after all, economists have their fashions just as much as the ladies have in their dresses--it seems to me that a very important thing has happened: that the wheel has turned and we have swung back again to a regard for central banking policy as a major economic factor.

If you want chapter and verse for that, take the statements of the Douglas and the Patman committees. I quote from the first page of both those documents. This was the Douglas subcommittee in 1950:

"We recommend not only that appropriate vigorous and coordinated monetary, credit, and fiscal policies be employed to promote the purposes of the Employment Act, but also that such policies constitute the government's primary and principal method of promoting these purposes."

And the Patman committee, chaired by someone who certainly wasn't in the old school of classical tradition:

"We believe that general monetary, credit and fiscal policies should be the government's primary and principal means of promoting the ends of price stability and high-level employment, and that whenever possible reliance should be placed on these means in preference to devices such as price, wage and allocation control and to a lesser extent selective credit controls, all of which involve intervention in particular markets."

Now let me very quickly expose to you what seem to me the broad periods in this forty-year history. This isn't a course on the Federal Reserve System, but I think perhaps the outline is as many of you give it.

The Discovery of Central Banking

The first episode, perhaps, was the discovery of central banking in this country. That dates from the nineties, after the panic of 1893 and 1896, and goes through the period of the report of the Monetary Commission, the Aldrich Commission, and up through to the establishment of the Federal Reserve Act. And for a series of years we had a study and exposure of the whole history of central banking as it appeared in the world. LOMBARD STREET became a familiar document in our schools and colleges. The feeling that a bank could exist that had a great public interest became imbedded in our philosophy. As a result the Federal Reserve System was established. I think, looking back at it, we would say it was a job on the whole extremely well done.

There have been a great many changes in the System, but the outlines of it and the general philosophy of it have remained through these forty years with relatively little major change. Perhaps the principal change has been one of emphasis. All of that early literature focused on how you get an instrument to deal with panics; how, when the panic has arrived, you deal with it. Now we go back of that. The framework constructed at that time was able to carry the broader load with some rather modest changes.

Experimentation and Testing

Then we go through a period of the heyday of central banking--from the establishment of the Act through until, say, 1933, when we had a period of experimentation, a period of testing. In World War I, the System demonstrated its utility as a mechanism for financing the war, for providing the funds that were needed. We went through that brief panic of 1920, with its tremendous drop in prices, and we learned something from it. We went again into the period of the twenties and the discovery of the major aspects of Federal Reserve policy. I think even today the 1923 annual report of the Reserve System is a standard document that can apply today to most of the things we do. We had the period of Ben Strong and his policies, which I remember so vividly, where he discovered the meaning of open market operations and wrote it down and made it a part of the literature of the time; it hadn't existed before.

Then we fought through 1928 and 1933 the losing battle against the forces of deflation. All of you, I am sure, in courses that you may give or things you may write, have your own explanations for that. But there it was as part of that period of testing and experiment.

Valley of the Shadow

I would like to suggest that the next period of the history of the System and of the relationshp of the Treasury and the System could be called the valley of the shadow, and that period dates from 1933 to 1951. It is a period when central banking lost its standing in this country to a considerable extent, and abroad as well.

Swamped in the wave of the great depression--for which central banking had to take its due share of blame--we turned to the new philosophies of Keynes, of consumer purchasing power, of the various kinds of controls that you might exercise. We tried to revise our own system here in the banking acts of 1933 and 1935. Fortunately, we didn't do too much damage, nor in the main very much good, although certain features were added that were helpful.

I suppose that period came to its apex in the nationalization of central banks. During that period, the records of the Patman committee showed that in the thirties about four of the banks were nationalized and after that, in the forties, there were ten of the central banks that were nationalized in terms of turning the stock ownership over to the government or making one or another move to put the control more directly under the government. Of course, the notable ones were the nationalization of the Bank of England and the Bank of France, where the Bank of England was under the law required to take orders from the Chancellor of the Exchequer after consultation with the Governor of the Bank--a curious phrase. Incidentally, that nationalization law was printed on just a single page, but it turned the bank from a private bank into a public bank in theory, although in practice the effect has been minor.

In France, of course, the head of the central bank and the Deputy Governor had been appointed by the government for a long time before. But the share ownershp had been in private hands; that was changed over. The council was changed and was appointed by the government rather than by the private shareowners.

I remember having lunch at the Bank of France. It was a rather dangerous experience; I was always sick after having lunch at the Bank of France because the food was so good. But I remember having lunch at the Bank of France in 1928 or 1929; the executive committee of the council was present with some of the large shareholders, and I found them seriously considering whether the franc shouldn't eventually go back to its 19 cents instead of the 4 cents that it was at that time. And I made a little note at that time that that kind of thinking was going to call for some sort of action some day. Of course, the nationalization of the bank was a perfectly logical step.

Then we had in this country the long battle--and I think indeed it was a battle--for survival of the Federal Reserve System with the forces of the government. I remember so well the day in 1933 or early 1934 when the lawyers from the Attorney General's Office came into the New York Federal Reserve Bank to arrange the turning over of the gold from the Bank to the Federal Treasury, and the gentlemen who were assigned that purpose certainly didn't believe in an independent central bank or a bank having any slightest shred of independence. And that period of eighteen years, from 1933 to 1951, was a struggle for survival of our Federal Reserve System in the face of a tremendous desire on the part of a great many people to bring the Federal Reserve System to heel. And it is greatly to the credit of the people in the Reserve System that they were able to preserve their very life through that period.

Revival of Monetary Policy

The period from 1951 on, I would say, could be designated the period of revival of central banking policy, of monetary policy, not only here but throughout the world. Of course, the most dramatic evidence of that was to be found in the European countries. It stands out very vividly to me because I visited Germany in 1946 and again in 1950. The thing that happened between those dates was the revaluation of the currency and the reestablishment of the German currency system after the Dodge Plan, devised by our own Joe Dodge, now Director of the Budget. There you saw an economy turning from night to day in the space of a few months when a sound monetary and fiscal policy was adopted. The same thing happened in Belgium; it happened in Italy; it happened in somewhat less degree in England. But you have had in these past years a demonstration of what sound money can do for a country that has hardly been equaled in the history of economics.

That process has brought out certain of the virtues of central banking as almost never before. One thing that has impressed me enormously has been the continuity of central bankers. The Bank of England in my generation has had three governors--Norman, Catto and Cobbold. While governments came and went, those three governors ran the bank; while governments came and went, those men stayed in power.

The same was true to a degree in the Bank of France. There you had the names of Moreau, who put the pressure on Poincare to stabilize the franc in 1926; Moret; his successor, Monnick; Baumgartner--a relatively few names, while if you tried to name the names of the premiers of France in that period it would be a very long list.

The continuity of those men and their ability, with government after government, to insist quietly and persistently on sound monetary policies was a demonstration of one of the major reasons why central banking can be the factor in a country's economy suggested by those quotations from the Douglas and the Patman reports.

Of course, in this country, in the Federal Reserve Bank of New York you have had three governors over this entire forty years of the history of that bank--Strong, Harrison and Sproul. In the Federal Reserve Board you have had a good many more leaders but a very substantial amount of continuity, carrying on from areas of one political complexion to another an emphasis on the mechanisms of sound finance.

Here in this country we have had in these years something of a miracle. You had a period in which the Federal Reserve System was under the dominance of the Treasury and in a battle for its independence of existence. I heard it said so many times when we discussed that battle over that period that in a battle between the central bank and the Treasury, the central bank never wins. In this case the Treasury had the backing of the President of the United States, but the central bank won the battle.

Through the accord in 1951, the System again regained its right to operate in the money markets in the way that was for the welfare of the people instead of acting to peg the prices of government securities to enable the government to borrow cheaply. It is one of the dramatic instances in history where the central bank regained the right to exercise its essential powers.

That battle was won partly due to what was perhaps in part accident but is, I think, a milestone perhaps in the history of finance in this country, and that was the fact of the Douglas and the Patman reports. You had two subcommittees of the Congress who conducted studies in the area of money and whose reports--gathering in the testimony of many of you here in this audience today--built up a volume on this whole subject of money that is most impressive. And the reports as they came out educated public opinion, and in my judgment, built up a background against which a central bank could win its battle with the Treasury and with the administration.

Well, now, I present those four stages of the Federal Reserve System just as a method of arranging that history as it sheds light on what we have today. What are the conclusions that we can learn as to the principles of monetary policy as they face us today?

Principles of Monetary Policy

The first principle, it seems to me, is that monetary policies are effective; that those quotations that I have read from the Patman and the Douglas reports are bolstered adequately by the facts.

Now, I believe also that if we looked back over that long period of history--and I am not going to introduce the evidence today--what we would see would be that the effectiveness of a central bank monetary policy depends on its action on the up-side of a business cycle much more than it does on the down-side.

The word "inflation", if you go to Europe, means an entirely different thing from what it means in this country. We don't know what inflation means. Inflation there has a connotation of economic horror that we know nothing about. And we have seen in these recent years the effectiveness of monetary and fiscal policy in dealing with inflation on the up-side of that swing.

Now, I think the Douglas committee report recognized that in its language pretty fully. I just call your attention to a quotation from that report:

"But we believe that the advantages of avoiding inflation are so great, that a restrictive monetary policy can contribute so much to this end, that the freedom of the Federal Reserve to restrict credit and raise interest rates for general stabilization purposes should be restored even if the cost should be a significant increase in service charges on the federal debt and the greater inconvenience to the Treasury in its sale of securities for new financing and refunding purposes."

Now, of course, that emphasis on avoiding the excesses on the up-swing of inflation sheds a little light on the interpretation of the Full Employment Act as an objective for economic policy. The danger of the interpretation of that act is that you should interpret it that every government agency should always be exerting its efforts to push things up; and what I am talking about is monetary policy exerting its efforts to keep things from going too fast, because when they have gone too fast, the down-swing becomes more serious.

The emphasis there, then, is on living properly and living soundly so that you don't get sick. The emphasis is on not going on an eight-day jag, rather than on thinking about how you can cure yourself after you get through the jag.

The third point that I would emphasize is that the Federal Reserve-Treasury relationship rests on mutual respect and understanding and offers no inherent difficulties. I believe that Senator Douglas' suggestion that good fences make good neighbors is a good principle that can be followed without too serious difficulties.

Incidentally, that is very similar to what was cited as an objective in the Republican Party platform: "A Federal Reserve System, exercising its functions in money and credit, without pressure for political purposes from the Treasury or the White House."

There were in those two reports a number of suggestions of mechanisms for trying to improve the relationshp between the Treasury and the Reserve System. One was the proposal for a credit or monetary council that would bring together the chairman of the Board of Governors of the Federal Reserve, the Secretary of the Treasury, the head of the RFC, the head of the Farm Credit Administration, and some of the others, for discussion of monetary and credit problems. Now, the difficulty with that, of course, is that it is the old organization problem. If you don't like what is going on in departments A and B, just put another department on top of them instead of trying to cure what is wrong with the relationship of the two departments. If the Secretary of the Treasury and the head of the Federal Reserve Board don't get along together, you don't help that by calling both together and putting them in a meeting with a lot of other fellows.

There is, of course, a good deal to be said for bringing under a general credit policy some of the other agencies of government, such as the Farm Credit Administration, the Housing Administration, the Export-Import Bank, the RFC, and so forth. But that is an entirely different question from monetary policy.

Now, the other suggestion made in these reports for dealing with this situation was that the Congress should give the Reserve System a more clear bill of particulars and define its relationship with the Treasury. I must say that is a suggestion for which one has to have a good deal of sympathy because, as you read the Federal Reserve Act, the statement of objectives is not too clear; it takes a good deal of interpretation. But the Congress has had a couple of whacks at trying to word that. The Board has tried to word it two or three times without succeeding. You bog down in a welter of meanings of words. You all know the difficulty of trying to agree on a statement of that sort. If you compromise and try to get it, the result is you usually find it doesn't apply when the next situation arises. So I am inclined to agree with Emanuel Goldenweiser's statement before the Patman committee that you don't need it; if you conduct your business as well as you know how, you don't need this extra bill of particulars.

The 1953 Experience

Those are the three principles that, it seems to me, arise from our experience with the System, and I would like to suggest that our experience in 1953 in the operations of the Treasury and the Reserve System illustrate exactly the principles that I have cited, and illustrate them in an almost classic way.

In the first half of the year, there was a bulge in employment, in production, in almost all of the economic indices. I asked our people to make up a list of the highs that were made in the first half year.

Production was at an all-time record. The index of industrial production reached a peak of 137 (on the new 1947-49 base) in both May and July 1953, which compares with an average of 124 for calendar 1952. (October index is 132.)

Production was exceeding sales, causing a threatening accumulation of inventories in the hands of both manufacturers and distributors. Total business inventories rose steadily until the end of September, increasing from $74.8 billion at the end of the previous year to $79.4 billion in September. (October inventories = $79.0 billion.)

The high defense expenditures, added to record plant and equipment expenditures and record consumer expenditures, put serious inflationary strains on the economy.

A continued rise in the money supply, after seasonal allowances, together with the prospect of a large Federal deficit in fiscal 1954, created inflationary pressures in the monetary and fiscal area. The privately-held money supply at the end of April stood at $192.2 billion, a new record for the month and $8.4 billion higher than a year earlier. (In October it was up $7.1 billion from a year earlier.)

Civilian employment was at an all-time record. The pressure on the labor supply reduced unemployment to the lowest levels since World War II, and forced large expenditures for overtime employment.

Personal income rose steadily to successive new records. The peak was reached in July at an annual rate of $287.5 billion, which compares with a figure of $269.7 billion for the previous calendar year.

On top of the high personal income, which reached record levels both before and after taxes, consumer purchasing power in early 1953 was being augmented by a rapid increase in consumer credit. Total consumer credit outstanding rose by more than $1-1/2 billion during the first half of the year, when a seasonal reduction is normally to be expected. It continued to rise in succeeding months, but at a diminishing rate.

Mortgage lending was also expanding. Nonfarm mortgage recordings (of $20,000 or less) in the first half of 1953 totalled more than $9-1/2 billion, or 13 percent above those in the same period of the previous year.

Business loans continued very high in the first part of 1953, and until the beginning of May they showed noticeably less than the usual reduction from the December seasonal peak. Total loans of all commercial banks increased $1.0 billion from the end of December to the end of March, as compared with an increase of only $0.1 billion in the same period of the previous year.

Expenditures for new plant and equipment reached a new all-time record in the first quarter of 1953, and continued to rise sharply in the two following quarters as previously-planned expenditures were carried out. Expenditures in the third quarter were at an annual rate of $28.8 billion, in comparison with $27.8 billion for the 1952 calendar year.

In the financing of this great volume of new capital expenditures, total new security issues for new capital (including both corporate and municipal) amounted to more than $7 billion in the first half of 1953--an all-time record--exceeding the year-earlier figure by 4 percent.

Total new construction reached a record volume in the first half of 1953, and the half-year total was 8 percent higher than in the same period of the previous year.

Reflecting the inflationary pressures in the economy during the first half of 1953, prices of commodities other than farm products and foods rose gradually but steadily until midsummer. Despite weakness in farm products and certain other materials due to excessive production, the broad all-commodity index rose to the year's peak of 111.0 in September, from 109.6 in the previous December.

In other words, what you had was the typical period of a business boom; and typically that called for a policy of restraint on the part of the central bank. It called for a policy of cooperation of the Treasury with the central bank in this policy of restraint, and that is exactly what was done.

In the second half year, the inflationary threat diminished as some of the indexes turned down. That was a situation that called classically for an easing of the pressures on money, and that again is exactly what was done.

So, gentlemen, I conclude by saying what I said at the start. There is no controversy between the Treasury and the Reserve System. There need be no controversy. We are both trying to do the same job of adapting our policies to the economic welfare of the country, and not to shorter aims.

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