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Address of Thomas B. McCabe,
Chairman of the Board of Governors of the Federal Reserve System,
at the
Pennsylvania Week Luncheon of the Philadelphia Chamber of Commerce,
Monday, September 27, 1948

You have conferred upon me a great honor here today in presenting me with the Chamber's 1948 Commerce and Industry Award and I thank you from the bottom of my heart. It means a great deal to me to know that you, among whom I have worked for so many years, feel that I have made a contribution to this community which merits such recognition. I have been connected with commerce and industry in this area for over thirty-two years and I can sincerely say that I have enjoyed every day of it. In recent years there have been a few interludes, you might call them, when I have been in Washington, but my heart will always remain here with my family, my friends and my business connections. I know the truth of the old adage that absence makes the heart grow fonder.

You know, most of us take our communities for granted and accept the benefits they offer without much appreciation or pride. For this reason I think the annual event of Pennsylvania Week is such an excellent idea. It focuses our attention on the fine things we do have around us -- abundant natural resources and rich man-created resources, wrought by our own brains and brawn. Only last week I flew over the state and I have never seen any countryside that matches the beauty and tranquillity of the eastern counties of Pennsylvania, especially at this time of the year.

Since pre-Revolution days the commerce and industry of Philadelphia have been vital to this nation, in war and peace. What amazes me when I contemplate our activities is their breadth and extraordinary diversity. Name any article that we use in our daily lives and the chances are Philadelphia commerce and industry have had some hand in making or processing or insuring or shipping or financing it.

Economists tell me this diversity, and especially the nice balance between the production of durable and non-durable goods, is undoubtedly responsible for the high degree of stability of employment and income in this area. The fine stable character of the people is reflected in the excellent relationships that exist between management and workers and the relatively low strike record that prevails.

It has been an exhilarating experience and a source of great pride to participate directly in the development of one unit of our local industry and indirectly in many others.

I thank you again Mr. Kaufmann and members of the Philadelphia Chamber of Commerce for this honor, and in accepting it I pledge to continue to give of my energy in helping you make this an even better community.

I would like to tell you something about my present assignment in Washington, and about the Federal Reserve System.

When the President asked me to take a place on the Federal Reserve Board of Governors and become its Chairman, I was frankly reluctant to go. Many of my friends here and my family were apprehensive about having me go back again to fight in the battle of the Potomac, as it is a strenuous life and the men in the spotlight positions are subject to the sharpest kind of attack and criticism. Since I had been connected with the Federal Reserve here in Philadelphia for several years, the System was in my blood and I could not resist the challenge and the opportunity to serve at a time when the need was so great. As one columnist so aptly said, "I was a sucker for a curved ball." I did not assume the office without searching appraisal of the responsibilities involved. This appraisal included the job the Federal Reserve has to perform in this critical period and the adequacy of its tools. My appraisal convinced me that the job could be done. I am still of that opinion.

Walter Leaf, the distinguished English banker, once declared that there are three main causes that dispose men to madness - love, ambition, and the study of monetary problems. And he added that the last was the worst. After some five months in office at the Federal Reserve Board, I know exactly what Mr. Leaf had in mind.

The Federal Reserve Act, passed in 1913, is a monumental piece of legislation and great credit is due its author, Carter Glass, for his foresight and wisdom. Its original purposes as conceived by its founders were to give the country an elastic currency, to provide facilities for discounting commercial paper, and to improve the supervision of banking. Over the years the System has developed a broader objective, namely, to help prevent inflations and deflations and to do its share in creating conditions favorable to sustained high employment, stable values and a rising standard of living.

There are over fourteen thousand banks in the United States, with total deposits of approximately 154 billion dollars. Eighty-five percent of the commercial deposits are held by members of the Federal Reserve System. These member banks keep their reserves with the Federal Reserve Banks. The Federal Reserve Banks are also depositories and fiscal agents of the United States Government.

The System is close to you and your businesses even though you may not always be aware of its operations. It was established on parallel lines with our political government as a federated system of twelve regional Reserve banks rather than on a single central bank just so that it could be quickly responsive to the economic and financial needs of each area and remain close to the grass roots. One of these twelve regional banks is the Federal Reserve Bank of Philadelphia, of which I was chairman for several years before I took the appointment in Washington.

The Federal Reserve System has both its national and local aspects and is a magnificent achievement in its provision both for centralized responsibility and decentralized operations, in its provision for active contact both with the executive departments and with the financial community. The Directors of the twelve banks, a majority of whom are elected by the local member banks, represent, with their branch directors, an excellent cross-section of the leaders in finance, commerce and agriculture of their respective regions, and I have found that their advice and judgment on the problems of the System are invaluable.

Each regional bank and the Board's staff in Washington are watchfully feeling the pulse of the economy, for the Federal Reserve research groups collect, correlate, and interpret a host of data about every "moving part" of the financial and commercial machinery. And the System is always working to maintain steadiness and strength in the field of money, banking and credit. In doing this, it has achieved a real status as an independent body, free from politics, serving only the public interest.

As everyone knows, the number one problem before the country is inflation. In analyzing the problem, the first question is -- How did we get in this position of high and continually rising prices? Basically the cause was the war, of that there can be no doubt. The productive capacity of the nation was largely devoted to war purposes for almost five years. At the peak more than fifty per cent of our record production was for war use. While millions of people were coming into possession of more money than any people had ever had to spend and save, there was a scarcity of things to spend it for. Consequently two great backlogs rapidly accumulated - a backlog of unfilled wants and a backlog of money savings. With removal of controls this pent-up spending power, plus an unprecedented volume of current income, was turned loose in a market characterized by scarcities and shortages. Prices, wages, and profits rose rapidly, and the spiral of inflation was on its way.

When you consider that half of our industrial capacity was taken up for so long with making the nonproductive tools of war, and that many millions in our labor force were paid to turn out articles they could not buy, it is amazing that the shock to our economy was so well withstood and that our recovery has been so orderly. I think that is a great tribute to the strength of our private enterprise system.

At present, the supply of money or potential money readily available to buy the current output of goods and services is about three times the prewar level. Yet the over-all physical volume of production of goods and services is little over a half larger than the prewar maximum. Production, it is important to emphasize, is practically at capacity. There have been only small over-all increases in physical output during the past year and a half, notwithstanding the great pressure of unsatisfied demands, expanding credit, and rising prices.

In spite of certain soft spots which are occurring in the price structure, the economic prospects indicate a continuation of strong inflationary pressures during the immediate future. Individual incomes have continued at a high level, with a tendency to increase as prices and wages have risen and employment has grown with the labor force. Consumer spending, based on current incomes, the use of past savings, and borrowing, also has continued to expand. Construction volumes seem likely to remain for a while at capacity levels, with possible further rises in prices in this field. Business expenditures are also continuing at a high rate. Government expenditures are increasing, primarily because of our European aid and defense programs. At the same time income taxes were lowered, thereby sharply reducing the Treasury surplus.

That's the situation we find ourselves in this autumn. What can be done about it?

Certainly no one authority or agency can accomplish the desired result alone. It is far too deep-rooted in the complexities of our economic and political life for that. However, within their fields the Federal Reserve and the Treasury have recently made four moves to check further growth in the supply of credit. These moves have been:

1. Higher short-term interest rates
2. An increase in the rediscount rate
3. Restoration of restrictions on instalment credit
4. An increase in bank reserve requirements

Time will not permit me to go into a detailed explanation of how these moves limit the supply of credit, because they are rather technical. You are all familiar, however, with the conditions of instalment credit, reimposed as a result of the authority granted by the Special Session of Congress. These conditions are less restrictive than in wartime, yet they will prevent much unsound borrowing and overreaching for goods.

Let me say that greater than anything else we can do from a Governmental standpoint is the maintenance of a Treasury surplus. Such a surplus means that more money is removed from the spending stream than our national expenditures put back into it. The difference, if used to retire that part of the debt held by the Federal Reserve System, reduces the money and credit pressure more directly than any other move. The Treasury had an excess of cash income over cash outgo of 9 billion dollars in the fiscal year 1947-48. But the prospects for the current year are for only a fraction of this amount.

This difference in the surplus reduces considerably the most important anti-inflationary influence.

I know there are many in this audience who would like me to say something about our price support of Government bonds. I will here repeat what I told the House Banking and Currency Committee on August second.

> It is my view that the System is obligated to maintain a market for Government securities and to assure orderly conditions in that market, not primarily because of an implied commitment to wartime investors that their savings would be protected, nor to aid the Treasury in refunding maturing debt, but because of the widespread repercussions that would ensue throughout the economy if the vast holdings of the public debt were felt to be of unstable value.

When you consider that the public debt is one and a half times all other debt in the country combined, it seems obvious to me that the market for the Government debt securities must be one where investors can deal at all times with confidence. I remain of the conviction that for the foreseeable future the support program should be continued. This conviction is shared by all the members of the Board of Governors and by the Treasury. It is also supported by the weight of financial opinion in the country.

During the past three months, non-bank holders of Government bonds - insurance companies, savings institutions and others - have greatly complicated our problem in this regard for they have sold over two billion dollars of these securities, thereby creating additional bank deposits and reserves of that amount. One of the results of the recent increase in reserve requirements of commercial banks will be to take up those additional reserves so that they will not be the basis of multiple credit expansion at this time when our credit volume is already out of proportion to the amount of goods available.

The problem of inflation is so vast in its causes, as well as in its effects, that it is everybody's duty to help in the solution. The welfare of our entire economy is at stake. Each of us must exercise real restraint in the use of money already in existence, and not bid for the scarce articles if purchase can be deferred. The hard fact is that we simply do not at this time have enough real resources to provide all the things we would like to have. If we insist on trying to acquire them anyway, we shall end by dissipating our resources through higher prices. The gospel of restraint in the spending of money should be taken to heart by every individual and by every organized group, public and private. The greatest possible economy should be practised by the Government, not only in direct spending, but also in the extension of credit by or under guarantees of governmental agencies.

Commercial banks have embarked on a program of voluntary restraint in the extension of credit, under the auspices of the American Bankers Association. This is an excellent example of teamwork and sets a pattern for cooperative effort which might be copied with profit by many other enterprises and organizations. And let me say right here that this nation owes a debt of gratitude to commercial bankers for their task in assisting with the financing of the war and for their general cooperation with the supervisory authorities in combatting credit inflation.

Few anti-inflationary moves are popular. In fact, checking inflation is a very unpopular pursuit. Each of us is inclined to feel that inflation is wrong and certainly something should be done about it - by someone other than himself. The Federal Reserve System has a responsibility to the country to use its statutory authority to the best of its judgment. Certainly we would be derelict in our duty and would violate our oaths of office if we did not "call them as we see them" and act accordingly. But the problems which now face the country are not the exclusive problems of the Federal Reserve or the commercial banking system. Action in the monetary field alone cannot readjust the unbalanced relationships within the economic structure which have already been created by inflationary forces, and cannot check further inflationary pressures arising from non-monetary causes. A great responsibility rests upon every citizen, upon every group or organization of citizens, upon the housewife, labor, industry, business, and financial institutions of all character to unite in combatting inflation and by cooperative effort accomplish the objectives which all recognize as essential to our well-being.