THE ROLE OF CED TODAY

An address by Thomas B. McCabe, Chairman
Board of Governors of the Federal Reserve System
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I am very happy to be back with so many of my old friends in CED again, as I have the most pleasant recollections of my associations with you during the formative years of this great organization. It was only a year ago that you invited me to return and discuss the Past, Present and Future of CED. When Marion Folsom asked me to appear on the program again, I didn't have the will power to resist, or the proper consideration, I'm sure, for those of you who sat here twelve months ago. I guess I just can't say no, especially when there is a chance to enjoy the fellowship of the CED.

When I see at first hand the constructive contributions this organization is making to nearly every major policy discussion involving our economy -- and particularly in the field of monetary, credit and fiscal policies -- I am prouder than ever to have had even a small part in CED's formation and early development. It has been several years now since I have had an active role in your activities so I really feel that I can comment freely and objectively on what you have been doing.

What a difference in the atmosphere today as compared with this time a year ago when we met together. The year 1949 was a year of healthy economic readjustment. The readjustments were moderate, and occurred, moreover, without the serious consequences that might have been expected after the prolonged postwar boom. After mild shakedown, there was marked recovery in production and employment. Toward the close of the first half of 1950, industrial production had been carried to a new postwar high. The demand for automobiles, houses, television sets and other durable goods appeared to be insatiable. This demand was generated by seemingly limitless reservoirs of savings and extraordinary use of credit, as well as by record levels of income. Plans for the expansion of plants and equipment that had been temporarily shelved during the shakedown were dusted off and new ones were drawn up. Business inventories increased. Prices and wages showed more than an incipient tendency to rise. The feeling of boom times spread and everyone wanted to share in them.

The CED has repeatedly emphasized in its various reports, and especially in the one issued yesterday, that the Federal Reserve should use to the maximum its statutory powers to help maintain a stable economy. We are fully conscious of our responsibilities. During the period of business slack in 1949 we used every means to make money and credit more freely available. Conversely, when the forces of inflation began to build up in the late winter and spring of this year, we moved in the opposite direction and raised the flag of warning. You will recall that in our testimony last February on the Housing Bill we pointed out the probable inflationary effects of too great a use of credit in this area.

At the same time we recognized, as you did, that achievement of the objectives of the monetary authorities would be severely handicapped by a government deficit. You have vigorously pointed out how difficult it is to combat inflation when there is a deficit.

I am sincere in saying to you that your broad objectives and ours have been the same, and that you have rendered invaluable assistance in bringing to the attention of the public the necessity for sound fiscal, credit, and monetary policies in this situation.

Had there been no outbreak in Korea, we still might have had a stiff battle on our hands to curb the forces of inflation, as inflation is a form of intoxication that dulls our true sense of values. If the public is not given a proper understanding of the nature of the problem, there is sure to be resentment against public authorities who try to curb excesses. Foresight, character, and great courage are required to cut back government expenditures, postpone public improvements, and levy adequate taxes. Furthermore, it is very unpopular to raise interest rates, to restrict credit, and to take the other necessary steps to effect sound fiscal, credit, and monetary policies when business has the desire to expand and the public is clamoring for more goods.

Even before Korea, prices and wages were rising. Korea added fuel to the flames. For the second time in a decade -- the third time in our lifetime -- we faced the grim prospect of meeting a large-scale preparedness program. The full nature and extent of the program that will be required is not clear. Uncertainty is implicit in the situation as evidenced from day-to-day headlines from Korea, as well as from other parts of the world where troubles are brewing.

Whatever the ultimate program, we know it will be large and it will require sharp adjustments in our civilian economy. Nothing would be more misleading, however, than to assume that the adjustments will necessarily be similar to those in 1940-41. If this is to be a prolonged "10 or 20 per cent war", as some have called it, our problem is to develop a program which is quite different from that required for an all-out war. In many ways, the problem is even more difficult than for full-scale mobilization, for we seek to maintain the essential character of free enterprise and yet divert a substantial portion of our efforts to build up defenses. The heart of the problem is how to do this and still remain flexible and grow in economic strength.

In viewing our problem, the fact that the moral issue has been resolved is of cardinal importance. The ultimate objective is now firmly fixed. Under the banner of the United Nations we have determined to resist by force, if necessary, a further corrosion of the foundations we have been building for a free world and a peaceful world for all peoples.

For this we need a strong, dynamic and free economy. Our leadership in world affairs, the success of our efforts to defend free institutions against aggression, rest fundamentally on the rightness of our cause and productive strength. It is no overstatement to say that the peace and safety of the democratic world are dependent on the flexibility and resiliency of the American economy.

The CED was quick to react to the new situation. It appreciated the serious economic implications involved. It promptly took a forthright stand on measures necessary to keep rearmament moving at full pace, and to curb rapidly accumulating inflationary pressures without undermining the foundations of our free enterprise economy.

Within two months -- almost to the day -- the CED Program Committee released its notable statement on an "Economic Policy for Rearmament". That statement proposed, first, the curtailment of government non-military expenditures and the pursuit of maximum efficiency in military procurement; second, increased taxes; third, an intensification of the savings program of the American people; fourth, primary reliance on nonbanking sources to finance government debt; and, finally, the establishment of credit curbs to restrict inflationary demands, particularly to restrain the dangerously rapid expansion of instalment, mortgage, and business inventory credit. The CED statement issued yesterday reemphasized these points.

In short, the CED has stressed the primary importance of a coordinated program of fiscal, monetary, and credit measures. These are fundamental. When they have been effectively applied, the occasion for direct controls becomes less general and their use can be limited to specific situations.

That program was a "ten-strike!" It correctly emphasized that unless we lived up to our responsibilities, the outlook for a serious inflationary spiral was foreboding. Inflation would diminish incentives. It would misdirect tremendous amounts of effort into non-productive areas. It would destroy the savings impulse of our people that has been so vital a factor in making our nation great.

Nothing would be more disruptive to mobilization than a spiral in which wages and prices chased each other. Nothing would serve more to increase the total cost of the defense program. Nothing could be more shattering to our civilian morale than for large groups of our citizens, particularly those dependent upon fixed incomes and money savings, and our great educational and religious institutions, to suffer untold hardships because of rising prices. Clearly, we must use every possible means to curb inflation.

The situation will not cure itself. The threat of still higher prices in the months ahead results not only from the existence of a strong demand but in many cases from mounting costs of labor and materials. Mounting costs mean mounting incomes. You are all familiar with the current pattern of price and wage increases.

These pressures will be augmented by the attitudes of business-men who are less cautious than earlier in the postwar period. The up-surge of buying in July and August demonstrates that the experience of a rapidly rising price level is fresh and vivid in the memories of many people. Profits are in record volume and incomes of individuals are also at record levels, and rising. Many businesses and individuals, moreover, are in a highly liquid position and therefore able to carry out extensive buying plans.

Certain important anti-inflationary steps, however, have now been taken. They are a good beginning and will help to hold the line.

Congress passed the interim tax measure and is now considering further levies. It is important that the CED continue to make available to the Treasury and Congress the results of its extensive studies of our fiscal problem, as it did in its statement yesterday.

In the credit field, the Federal Reserve System initiated a broad program to curtail credit expansion and limit growth in the money supply. Open market operations have been directed toward making bank reserves less readily available. Discount rates have been raised from 1-1/2 to 1-3/4 per cent at all Federal Reserve Banks throughout the country.

I think the significance of these moves has not been generally understood. Let me assure you there is much more to these actions than a fractional increase in short-term interest rates to borrowers. Essentially, these actions are designed to discourage the sale of government securities to the Federal Reserve. Such sales supply reserve balances and provide the basis for a multiple expansion of credit. Rising interest rates are reflected in lower market prices, and a bank's finance committee does not like to see its portfolio of short-term government securities in the red. A bank is then penalized if it sells those short-term securities which it purchased at a higher price to get funds for making loans.

Consumer instalment credit has been brought under strict curbs through Regulation W. Further extensions of home mortgages will be subject to the stringent terms of Regulation X as soon as the backlog of existing commitments is worked off.

These special regulations over consumer and housing credit are designed to reduce inflationary forces particularly in areas of sharp expansion. They are intended to restrict the demand for houses, automobiles and other consumer durable goods to the smaller supplies that will be available as the defense program mounts. In this way, they will help to assure that the needs of the defense program for materials and labor will be adequately met without adding to the wage-price spiral. Nothing is more important to our people at home, as well as to the free peoples of the world, than preserving the intrinsic value of the dollar. Judging by the avalanche of complaints, these regulations seem to be effective. Our daily problem is to analyze the facts and to judge if their impact is accomplishing their intended objectives without undue hardship. We must be flexible enough to change them either way as the economic situation may require.

Some automobile dealers are unquestionably being hard hit at the present time, particularly those who built up large inventories of used cars at high prices. It is natural that they should protest vigorously. Our letters are not confined to protests, however. I have received letters which have been tremendously encouraging to those of us who have to administer this regulation. People sing a different tune once they appreciate that the only alternative is a system of rationing and price and wage controls. The fact is beginning to be better understood that our actions are essential to maintain the purchasing power of the dollar.

Repeatedly I have had individual dealers and manufacturers say to me in effect that these regulations are really going to hurt, but as citizens they can understand that the stakes are much bigger than their own business. If anything can be done to hold down inflation, they say, especially without resorting to widespread direct controls, then they feel that their businesses will be hurt much less in the long run.

That is the kind of objective comment I associate with the CED. It has remained throughout the years a constructive, forward-looking organization of our foremost business leaders. No matter what problem the CED has tackled, it has brought imagination and drive to the development of a positive policy program in the <u>national interest</u> -- and I want to underscore those two words.

We will need this imagination and drive more than ever during the next six months. I am happy that the CED does not intend to rest on the policy program issued in August. Congress is about to return and will be searching for guidance from this organization, as well as many others. The fact that prices are still rising and wage increases are still spreading throughout the economy is a matter of great concern to the public and will be especially to the Congress. The paramount question today is whether or not we are going to adopt a comprehensive harness of direct controls.

There seems to be a feeling that we will not have the courage to put the budget on a pay-as-you-go basis; that we cannot resist the pressure groups who will demand government expenditures for one purpose or another; that we will not really push credit and debt management policies to the point where growth in the money supply is arrested; and, further, that even if we do, the impact of these measures will be too slow and that wage and price controls must be adopted immediately if we are to stop inflation in its tracks.

Now I feel sympathetic with both sides on this question. I know that you manufacturers who are currently in the midst of wage negotiations are aware that what you do may help to extend a pattern of wage increases throughout the economy where it may become frozen into a higher level of prices. You must feel that our so-called indirect controls are too slow, that they are inadequate, that the inflation will be here before they have had their effect. I could therefore put up an argument on either side of this burning question.

It is obvious from the public discussions, that there is no general agreement on a hard and fast answer to the question of direct vs. indirect controls. In my opinion it depends entirely on the magnitude of the defense program. That, gentlemen, is the key to the riddle. We all know that if we have to go to an all-out mobilization we will of necessity adopt direct controls. We will adopt them with our eyes open, knowing that they will not eliminate inflation but simply postpone its impact. We will know, too, that in some areas they will encourage inefficiency and waste and in others impair the flexibility of our economy. We will incur these risks because an all-out mobilization will require that the economy be subject to command and you cannot command without the power to enforce the decision.

If the magnitude of the defense program falls short of all-out mobilization -- if it remains within its current dimensions or does not go too far beyond the present program -- then I feel that overall direct controls can be avoided. Under these conditions it should be possible by means of coordinated action on the fiscal, monetary, and credit fronts to hold the money supply and reduce aggregate civilian demand to the limits of the very large volume of goods that will still be available. Further, I agree heartily with CED's statement that at the same time we should use vigorous measures to stimulate production. If we do these things, we can minimize the inflationary effects and preserve much of the initiative and flexibility of our American free enterprise system. I recognize, of course, that in addition we will have to use limitation orders and resort to allocations in restricting less essential demand for certain critical materials.

The preservation of a strong domestic economy is a most important factor that should not be overlooked in the determination of the military budget. Just as in World War II when we were the arsenal of democracy, I believe that victory in any future crisis will depend in large part on the productivity of our economy.

If the defense effort is to be met successfully without the imposition of direct controls, the CED has plenty of work cut out for it. It will be no easy task. Your greatest obstacle will lie in a widespread misunderstanding of the nature of the problem -- misinterpretation of the measures you advocate to deal with it. You will need economic education at the grassroots level. The CED has demonstrated in the past that it can be geared to meet that need.

I think the challenge to CED today is to find ways to prove that indirect controls can do the job of restraining inflation with a military program of the present announced magnitude, and that our economy will actually be stronger and more able to meet later emergencies if it is unfettered now.

The Committee for Economic Development was organized in 1942 by a group of business leaders who were convinced that the solution of postwar economic problems could not be left to chance. This required first the development of positive programs for resolving problems; second, a program to educate leaders of commerce and industry at the grassroots throughout the country; and, third, an effective and objective presentation of its views to the policy-making officials of government. The endeavor was eminently successful and CED, through its continuous research program has added to its accomplishments by constructive contributions to the solutions of many types of economic problems.

Today we face, in all likelihood, a prolonged period of heavy governmental expenditures for defense efforts. In a real sense it will be a steady drain on our resources of materials and manpower. It could lead to a gradual undermining of our productive strength and a weakening of our entire financial structure and free enterprise system. To prevent this erosion requires the same ingenious inspiration that carried the CED to such early heights and has sustained it at those high levels ever since. This is a challenge of equal importance and significance to the one CED faced at the end of the war.

The role of the CED is clear and significant. The need for a steady flow of its positive policy recommendations is acute, but here progress is definitely being made. The importance of a grassroots selling campaign to promote more widespread understanding of basic objectives is imperative. I hope that sufficient attention will be given to this phase of your program because without it, the whole struggle to preserve a free economy may be in vain.

Over the years, the CED has built up an enviable reputation. What it has to say on public questions commands the widest attention and respect because it has never spoken from the standpoint of narrow interest. With that reputation goes a responsibility -- especially in this time of trial and test of American institutions. You have an opportunity now to spread understanding to all parts of this land of what is at stake in these fundamental issues.

In the final analysis what needs to be made universally clear is that while price, wage and the rest of the horde of direct controls may restrain inflation, they conceal its source. Therein lies a great danger. By covering up the source, they tend to weaken the popular will to deal with the causes of the disease. As you so well know, the source of every great inflation has invariably been in the money supply.

Adequate and effective taxation and credit measures are the basic remedies that go to the root of this disease. Direct controls are not a substitute for strong fiscal, monetary and credit measures. They only supplement them. If the magnitude of future defense requirements ultimately compels us to resort to the harness of direct controls, we will still need to carry as heavy a tax load as can be managed. We will still need the most rigorous economy in postponable public expenditures. We will still need to curb expansion of the money supply by restraint upon bank credit. We will still need vigorous measures to stimulate production.

Unless we do these things, we may temporarily ward off but we will not defeat inflation. The battle is worthy of all we have -- to win the victory.