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Board of Governors of the Federal Reserve System

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OUR COMMON TRUST

Today I would like to talk with you, as one trustee to another, about something that seems very important at the moment; something in the nature of a common trust.

There is a close relationship between professional trusteeship and that exercised by the Federal Reserve System. One might even label it a co-fiduciary relationship. The beneficiaries of your trusts and ours overlap. We both are required to exercise care and skill, prudence and sound judgment; we are obligated to exclude all conflicting interests and pressures in administering our respective trusts; we are all subject to the same duty of complete loyalty to the trust.

Money and credit are the corpus of the Reserve System's trust - a trust that must be administered for the benefit of all the American people. How we administer that trust has a tremendous bearing on how you can administer yours and at the same time your activities have a distinct bearing on ours.

Bankers should be more conscious than most businessmen of the contribution of stable values to economic progress. Your unique position of responsibility to both providers and users of a bank's funds - to both depositors and borrowers - points up this relationship. What does it profit the man who builds a savings account in your bank if the buying power of his funds has shrunk substantially when the rainy-day need for them materializes? Similarly, you know firsthand the plight of the borrower who, when economic conditions deteriorate and values decline, faces a far heavier burden in repaying his debts.

You bank officers with trust responsibilities are acutely aware of the vagaries of fluctuating values, because of the pronounced effect which they have upon your ability to carry out the wishes of those who have entrusted their funds to your safekeeping and management. Each of you could draw from your experience in the recent past numerous examples of trust accounts which now fall far short of the original objectives of the grantors because of drastic contraction of the buying power of principal and income.

Your concern with a prevailing economic climate that is conducive to stable values, to a steady expansion of our national wealth, to maximum employment, and to a rising standard of living parallels the primary objectives of the Federal Reserve System. Consequently, you must be as concerned as I am over the widespread misunderstanding - or, perhaps more accurately, lack of understanding - of some of the efforts being made to provide that sort of climate.

Let me make it clear at the outset that I do not decry criticism. Freedom to criticize lies at the very base of democracy, and the exercise of that freedom is essential to its preservation. One who cannot accept and benefit from intelligent criticism should not be entrusted with the people's business. Consequently, criticism is entitled to impartial appraisal. Sometimes this is not easy. Knowledge of a critic's past performance may lead one - at times unjustifiably - to overemphasize the source and underestimate the substance.

For example, on returning from my vacation recently, I read one particular blast on monetary policy, and immediately found my mind dwelling on the new "hand" who, years ago, rode a vivacious pacing mule into the ranch on which I was working near Broken Bow, Nebraska. To hear him tell it - and I still can - he was the world's best cowhand. He said that, like the rest of us, he had always ridden horses until the day before when he had picked up this mule, but that no horse could compare with it. He regaled us with its qualifications. And I must admit it was an unusually intelligent and gifted animal - so much so that it soon showed evidence that it wasn't as pleased with its new rider as he was with it. It apparently objected to being ridden by one who seemingly wanted to go in opposite directions at the same time and at an indeterminate speed. It objected to being neck-reined in one direction and simultaneously kneed in the other, to being spurred and checked in the same breath. Its display of dissatisfaction was a tribute to its intelligence and capacity; in fact, it was sufficient to get the rider out of the saddle and cause him to berate the animal in no uncertain terms. He could not say enough bad about the mule. It had, he said, none of the qualities he had previously raved about. So, with the view of satisfying him, we brought in from pasture a young sorrel horse. He bubbled over with praise when he saw it. It was a beauty; smart-faced, small-necked, large-chested, short-coupled, and well underpinned with strong but finely tapered legs. It was the kind of horse he said he had been looking for all his life. But when that horse refused to let him even saddle it, let alone get astride it, he went off mumbling loudly and bitterly about both animals. We suspected he was talking out of personal pique.

Such suspicions must be brushed aside in order to appraise properly and fairly criticisms of monetary policy. When we do so, it is apparent that some of them are based on thorough study, close analysis of information, and reasoned judgment. Those deserve the most careful attention. However, even under the lights of impartial appraisal, others seem to be based on the loose word, the personal pinch, the fears which have been instilled by a vocal few who consciously or unconsciously distort facts for personal gain, or for the sake of appearing wise or striking at a political adversary.

It would be unfortunate if monetary policy should be made the subject of demagoguery or used as a political football, because it is perhaps as important as any single factor (other than war) affecting the economic welfare of the people of the United States. It is unfortunate that the subject lends itself so well to distortion. There is no topic I have ever encountered that is more difficult to grasp - and, even more vital, to deal with effectively - than the problems of money and credit in a modern economy. Unfortunately, too, certain of the superficial and obvious results of monetary policy are apparently bad. But the concentration of one's attention on these phases may result in missing the real values and the real problems involved. Let me exemplify with a bit of recent history.

During the past two years production and employment have been at very high levels. The buying power of the dollar has been relatively stable. Credit has not been so easy to obtain, and when obtained it has cost a good deal more than it did in 1950. Those changes in our financial situation have not been coincidental. Each of the changes is related to the others; no one of them could have happened alone.

Yet there are superficial analyses made constantly, stressing only one aspect: that when public utilities issue long-term bonds, they may have to pay 4 per cent for the money instead of 3; that when an individual buys a home, the interest rate on his mortgage may be 5 per cent instead of 4; that when the "big borrower" - the Federal Government - borrows for 91 days, it pays for that money at the rate of around 2 per cent per annum - more than twice what it paid a few years ago.

That looks pretty bad! We are told that higher interest rates make it more costly today for a man to buy a home for his family; that taxpayers - you and I - bear a heavier burden because Government has to pay millions more in interest every year.

But what about the fact that the man who wants to buy a home for his family no longer has the jitters that come from constantly jumping prices? And what about the fact that the Government no longer has to pay billions more every year for the things it purchases, as happened when inflation was swelling Government costs? The superficial analysis finds it convenient to ignore those facts, and attempts to conceal the omission with talk about higher interest rates providing a bonanza for "the great corporations and the banks".

You and I are aware of the fallacies in such arguments. We know that the most important single group of "great corporation" investors is the insurance companies, which are simply intermediaries, to a large extent, between the borrower and tens of millions of insured individuals and beneficiaries - the rank and file of the American people. The "banks", as we all know, will not realize a windfall from the change in interest-rate patterns; in addition to being recipients of interest they are also payers of interest on $60 billion of time deposits, and the percentage return on capitalization of the American banking system has not shown any startling increase as a result of high interest rates.

We also know - even if the detailed reasoning is a little fuzzy in our minds - that today's higher interest rates are in no sense an end in themselves, but are simply, in view of the great volume of demands for credit, an inevitable accompaniment of a very honest effort to re-establish the dollar as a dependable standard of value, with all the resultant tremendous benefits to every segment of our economy.

That is, very roughly, the basic truth of the money-market situation in 1953. We know it, but only because understanding it is our business and we have laboriously thought about it - off and on - for many years. But the American people, generally speaking, do not know about it. It is difficult to present these facts in dramatic - not to say sensational - form, whereas the superficial appeal for tears on behalf of the "harassed taxpayer" or "struggling home owner" is only too easy to present and to comprehend.

Therein lies the task that confronts us: to bring about broader public understanding of the essentials of a very complex problem. It is a difficult task, but a task which we must perform - and right now - or be ready to accept the consequences. As Edmund Burke said: "The only thing necessary for the triumph of evil is for good men to do nothing."

Our task, yours and mine - and I hope the critics will join us in it - is not to try to "sell" Federal Reserve policies and action, but rather to help the American people get what they are entitled to: a fair understanding of what is happening in the monetary field and why, and what the alternatives are. A man who does not know that may be misled by a "tag" applied for prejudicial purposes, a tag such as the "hard-money policy" or the "easy-money policy" or something else. But Americans - knowing the facts and the choices - are not going to be misled by anyone.

What is the monetary policy of the Federal Reserve System? Its policy - the only monetary policy it has - is to make available all the money and credit the economy needs for normal operation and for healthy growth - but not so much as to induce inflation or so little as to cause deflation. The purpose, in line with the goal Congress has set for the System, is to see to it that boom-and-bust cycles do not arise from money and credit causes, and to moderate cyclical movements stemming from other causes. (In passing, it should be borne in mind that while one must not underestimate the role of monetary policy, he will do well not to exaggerate it, either. Even in economics "money isn't everything". The whole matter of credit supply is only one factor affecting the Nation's well-being.)

The credo that underlies Federal Reserve policy and purpose is our conviction that stable values - in the main a dollar that will buy the same amount of goods and services from one year to another - are necessary to aid the growth of the economy and improvement of the standard of living for the people as a whole. Please note, I said "the people as a whole". We do not dispute that a dollar that keeps buying less and less would benefit some people, but we must not forget that our responsibility is not to some, but to all of the people.

When one is intent upon the welfare of the people as a whole, it seems strange to hear arguments which, stripped of their camouflage, are against a dollar of stable buying power and in favor of a dollar that will buy less each year. Nearly all American families have savings in some form - pension contributions, life insurance, savings accounts, savings bonds, or something else - upon which they will be depending in old age, if not before. Will they be helped by a cut in the buying power of their savings?

You and I know that one reason why this country has the highest standard of living in the world is that many have saved, and their savings have been invested - if not by them directly, then by the banks or life insurance companies or other institutions to which their savings were entrusted - in the tools and equipment that have helped achieve for America the greatest production in history. What incentive would there be to save if today's dollar saved were worth less and less each year?

During the two and one-half years in which the Federal Reserve has been following its present monetary policy, we have had, as I said at the outset, a high level of production and employment and a relatively stable level of prices. That may be some evidence of the worth of our policy, although these desirable conditions certainly did not result from monetary policy alone, and I would claim no more than this: conditions would not have been so good over this period, or today, had the Federal Reserve permitted credit to be created without limit.

If one is to pass judgment fairly and intelligently on present monetary policy, he must consider the alternative. Broadly - and at extremes - there are two alternatives implicit, if very seldom openly stated, in criticism that has come from two directions, sometimes from critics who seem to want to go in both directions at the same time.

One alternative would be to "freeze" credit at a fixed level, or even to reduce it. This would mean disregarding the fact that needs for money and credit increase in a growing economy. This alternative would stunt economic growth and lead to a contraction of production, employment, and purchasing power; and no one could guarantee that the ensuing downward spiral could be stopped at any point short of chaos. You and I want no part of that.

The other alternative would be to create credit without bothering about the extent to which it can be absorbed in normal operation and growth of the economy. But at a time when virtually all workers, plant, equipment, and natural resources are already employed and production is practically at the presently-achievable maximum, additional credit can only produce higher prices that benefit few and lower the standard of living of many. You and I want no part of that either.

Adherence to present Federal Reserve policy has meant that the available supply of money and credit has not been sufficient to meet all demands. And this in turn has meant that the cost of obtaining credit has risen. In other words, interest rates are higher. But let me emphasize that the Federal Reserve System is not interested in promoting higher interest rates. The choice is not between "high" and "low" rates. Rather, the choice lies between (1) letting interest rates rise - and fall - through the interplay of the demand for credit and a supply attuned to economic needs, and (2) on the other side, expanding the supply of credit to drive down - or hold down - interest rates, even though the excess credit thus created accomplishes nothing except a rise in prices. We have chosen the first course, in the belief that it is in the interest of the people as a whole.

Naturally, our choice has not been popular with some lenders, who could not obtain all of the funds they would like to lend, and with some would-be borrowers, who could not obtain as much credit as they would like. This is simply inevitable. I would doubt the efficacy of any governmental decision that was not greeted with catcalls by some group or other. Even the Harrison Act was unpopular with smugglers and peddlers of narcotics - although they were not in a position to vocalize their opposition effectively. Speed-limit laws doubtless are unpopular with those who would rather drive 80 than live to that age.

When you boil it down, we simply try to apply John Stuart Mill's utilitarian principle - the greatest good for the greatest number - always bearing in mind that minorities also have rights, unless what they want is unduly injurious to others. And so it is that the very limited benefits of an uncontrolled money supply are overwhelmingly outweighed by the evils - not only unfairness to fixed-income groups and an arbitrary and irrational redistribution of purchasing power but, even more fundamental, the uncertainty and instability that discourage the planning, the effort, and the initiative on which our economic progress depends.

Some would have the Federal Reserve System support the prices of Government bonds at par - or higher. In World War II, when the Nation's survival was at stake, we did just that, as you know. The prop thus put under Government bond prices did keep interest rates low. But it had a consequence that became painfully apparent in the post-war period. Marketable Government bonds not maturing for a decade or more became, in reality, interest-bearing cash; and their conversion into Reserve Bank credit, at the owners' option, was the practical equivalent of pumping into the economy a virtually unlimited stream of newly printed dollars. The number of dollars rose faster than the volume of goods and services, and price inflation was the inevitable result.

Under the accord reached with the Treasury Department in March two years ago, this pegging arrangement was stopped. The artificial prop under the prices of Government securities being removed, those prices declined. Concurrently, of course, yields rose. But the significant point is that lending institutions lost their eagerness to convert bonds into Federal Reserve credit, and the business of turning promises-to-pay-in-the future into lendable cash was checked. So was the slump in the buying power of the dollar that had been going on for years.

Now remember, that wasn't yesterday, or last June or January. It was two and one-half years ago. And it was not done to win votes or popularity, or to benefit any particular group, or faction, or section. It was done in the interest of all the people and with one simple purpose: to keep the expansion of credit within economically healthy bounds, so there would be no overswollen supply of money to bring on further shrinkage in the dollar's buying power - and eventually a boom-induced bust.

I do not say, or think, that the Federal Reserve System chalked up a flawless achievement in this undertaking. We have no omniscient supermen among us. In over a quarter century of public service I have yet to encounter one - in or out of Government. Rather than claiming superior wisdom, we disclaim it. This disclaimer is inherent in the policy of letting interest rates be determined by the forces of demand, in a freely functioning market, and by the forces of a supply that is geared to meet economic needs rather than to fix interest rates.

The Congress has made it clear that the guiding principle underlying the Federal Reserve's activities is the advancement of the public interest, particularly through the maintenance of "sound credit conditions", as the Federal Reserve Act puts it. Pursuant to this principle, the System attempts to make credit more available whenever that seems to be necessary or desirable for our country's continued economic progress, and to make credit less easily available when there is a threat of a detrimental overextension of credit. We consider it our duty to take action within our competence to aid in averting both inflation and deflation, while seeing to it that the economy is aided in its steady expansion by an adequate but not excessive supply of credit, the lifeblood of industry, agriculture, and commerce.

Our job is as simple as that - in purpose. In practice, it is no simple thing to determine exactly when action should be taken, and precisely what form of action it should be. There is, I might say, room for differences of opinion in these matters. In fact, on some recent occasions, that room seemed somewhat crowded! However, every decision is the final product of infinite pains in the gathering of enormous masses of factual information, the analysis of that information, and the formation of judgments and policies. We make mistakes, but we do our honest best to make right decisions, irrespective of pressures.

Even so, and in evidence of my thesis, there is considerable misunderstanding regarding our purposes and methods. When the Federal Reserve System refrains from buying Government securities for a month, rumors fly about that we have adopted a "hard money" policy; and when we enter the bill market again, a story gets around that we have reversed our policy and are out for "easy money" conditions. (Sometimes it has seemed there was more inspired trading in the rumor market than in the bond market.)

The extent to which such misunderstandings and rumors are disquieting to the financial and business communities is proof of the need for our united effort as trustees to proclaim the whole truth - and nothing but the truth. We have seen in our generation not only the awful power of the "big lie", but - skillfully used - of the little lie as well; the slanted statement, the crooked emphasis. It is up to us to reaffirm our confidence in the greater power, in the long run, of the "whole truth". It is more difficult; it is considerably duller, I am afraid; but it is the only salutary course open to us, and we must take it.

Nothing is more important to this country today than a renewed respect for truth and candor, not only in governmental actions and statements, but in those of private citizens, for there - ultimately - is the measure of public morality, which can rise no higher than its source.

Although reluctant to play the role of Jeremiah, I feel obligated to speak out against the spreading tendency to talk carelessly and without due consideration, to repeat rumors that are probably baseless, to give a misleading twist to an otherwise truthful statement. All of us, public servants and private citizens alike, must reject the glib, the easy, the superficial, the deceptive - the kind of thinking and talking that too many of us have been doing increasingly in recent years. We must first make sure we know what we are talking about, and then speak out with utmost clarity and utmost honesty. In this sense we are all trustees not only for those who are technically an institution's cestuis que trust, but for all the American people, for whom we should hold in trust - and for distribution - understanding of basic economic truths.

We must realize that today's problems are worthy of solution, although seldom easy to solve. This realization, somehow or other, must permeate the attitude and the thinking of the American people. When the citizens of Athens met in the agora, they usually had a few simple problems that the average man could comprehend and vote upon with intelligence. Let us face the fact that this is not possible in the twentieth century. The complexity of our civilization and the magnitude of our problems make this approach impossible and impose on all of us a great responsibility to contribute toward public enlightenment.

The American way of life, in its factories, its transportation, its banks, is almost frighteningly complex. It takes a lifetime to master only one of its myriad phases. But this intricate mechanism is more than a machine. Its continued operation, and its values, depend upon the intelligence, the determination, the spirit of individual human beings. Eternal vigilance is the price of the wonderful structure we call Western civilization, which will stand only as long as its people retain and cultivate the qualities that gave it life - the simple virtues of energy, courage, honesty, and mutual trust.