



ur

*American
Economy*



TEXT OF AN ADDRESS

by

WM. McCHESNEY MARTIN, JR.

*Chairman, Board of Governors
of the Federal Reserve System*

at

Luncheon Meeting

of

The Executives' Club of Chicago

Grand Ballroom, Hotel Sherman

Chicago, Illinois

December 12, 1958

OUR AMERICAN ECONOMY

During the past year, we have had both recession and recovery and now, once again, fear of inflation. Despite the best efforts of the Federal Reserve System to explain its objectives and point of view to the general public, questions are again arising as to the basic purposes of monetary authorities. These queries are legitimate, but the answers have been given repeatedly. The Federal Reserve System is designed to regulate the supply of money in order to foster high levels of employment and stable prices. Stability is not an end in itself but a means by which this higher standard of living can be attained and without which a lower standard of living becomes inevitable.

From time to time the charge is made that the Federal Reserve is seeking a recession and would like to see a little unemployment. Certainly nothing could be further from the truth. The Federal Reserve's paramount purpose is to contribute, so far as it can, to sustained economic progress without the painful setbacks that mean waste of human and material resources.

There are many types of unemployment and many causes of unemployment. All of the factors that go into unemployment must be carefully considered and sympathetically studied. For residual unemployment, or temporary unemployment, we have unemployment compensation benefits. The major problem, however, is how to get people to work and give them jobs which will be permanent and profitable. How easy this would be if we could only achieve it by just spending more money. Unfortunately experience has

demonstrated you cannot spend yourself rich. Lasting prosperity only comes from hard work, producing goods and services which people need and want at prices they are willing and able to pay. At the moment we have unused capacities in industry and larger levels of unemployment than we would like to have. Why has this come about? Because of tight money? Not a bit. It has come about because inflation got ahead of us as evidenced by the fact that at one time in 1957 we were losing more than \$1 billion a month in prices in our gross national product without additional goods and services being produced for the consumer. The seeds of inflation were sprouting into the temporary over-capacity which we now have and a decline was inevitable.

Let us not be misled by comments to the effect that the consumer price level is now stable. The process of inflation in this country started over ten years ago during our war-time period and with minor interruptions from time to time has persisted ever since.

The Federal Reserve System has leaned against the wind whenever it has been clear which way the wind was blowing. In 1957-58, when a decline was under way, we pursued an easy money policy, in order to give whatever assistance an enlarged availability of money could give to alleviating distress and laying the groundwork for recovery. This was largely achieved by the end of April of this year. Accordingly, Federal Reserve policy was modified, as it always should be, in adaptation to the change in economic conditions. At the present time, with increased demands for funds, with improved productivity, we are witnessing a strong economic comeback and we are now beginning to see a gratifying decline in unemployment figures, although the total is still higher than any of us would like it to be.

Let us not succumb to the belief that these unemployed people will be assisted by flooding our economy with a stream of easy money. The better way to get these people back to work is to concentrate on fundamentals that permit the forces of the market to operate. Rising interest rates, when they reflect a response to improving business conditions, have never been a sign of weakness. When artificial forces prevent their rise it may well lead to knots which would complicate rather than assist our progress. If business conditions continue to improve it is normal to expect interest rates to rise; if business stays where it is interest rates will probably stay about where they are, and if business begins to decline interest rates will decline. But let us not be carried away into thinking that interest rates are such a dominant force in the economy that they possess some magic so that they alone can determine the level of employment, unemployment, and use of capacity — at high or low levels. To me it is vital that we understand this crucial point.

A recent trip to several countries of the Far East gave me a welcomed opportunity to see ourselves as others see us. One distressing experience was to find among intelligent and perceptive men in those countries a growing distrust over the future of the American dollar. Whether or not it is justified — and certainly I think it is not — it is important to recognize that this feeling exists.

To the foreigner, much more than to Americans, the dollar is a symbol of this country's strength. A decline in the value of the dollar would suggest to him a decline in the faith and credit of the United States, signaling in his mind a decline not only in American economic strength but also in moral force.

Naturally I was interested in the basis of distrust. Two matters appeared uppermost. One was a conviction that, not necessarily at the moment but in a fairly short time and more markedly in the extending future, American goods are going to find themselves priced out of the market. Indeed, I was told that some countries to which we have made loans conditioned upon the purchase of American goods would, except for that restriction, already be turning elsewhere for their purchases.

You will recall that this same sort of talk was directed at Britain for about a year before the British got into trouble and had to devalue the pound sterling. I don't think it is going to happen here. I wouldn't talk about it if I did. But it is something for us to be concerned about.

The other thing cited to me as a reason for foreign distrust of America's ability or will to preserve the buying power of the dollar was the \$12 billion deficit that has developed in the United States budget, plus possibilities that further deficits may follow.

It was amazing to me how closely our budgetary developments were being followed in such remote areas as Thailand and Hong Kong, and how many people there knew our precise budget figures better than most Americans.

Of course a simple fact of human nature has added intensity to their interest. They all know, many through personal experience, of the stern lectures America has given foreign countries about their need to have the moral fiber to put their finances in order. And, as a widely traveled American businessman recently suggested to me, it is only natural that foreign countries should be wondering if we have the capacity to take the medicine we have so freely prescribed for others.

Now I don't think anyone abroad or at home questions the ability of the richest country in the world to "afford" whatever amounts are needed for the national defense of the United States and for social benefits the American public demands as well. Certainly I do not question it myself.

The question that I ran into was something else: since Americans clearly can *afford* these expenditures, why don't they *pay* for them? That is, why don't they pay in taxes or reduce other programs instead of giving I.O.U.'s or simply printing more paper dollars? That also is something to think about.

Now let's discuss this matter of the budget. No reasonable man believes that budgets can always be balanced. Likewise, no sensible person believes that an unbalanced budget is a desirable way of life. This, of course, has moral connotations as well as economic.

We are a rich country. There is no reason to be ashamed of it and we do not need to apologize about it. We must recognize that some people in our society are not as rich or well off as we would like them to be. As a nation, however, we can afford to expend whatever is required for national defense and foreign aid. Naturally we don't want waste in these projects. Whatever is required we can afford to spend, but we cannot afford to spend it if we are unable to find the means of paying for these expenditures in any other way than by printing money. Regardless of what facile justification or technical obscurantism is used to persuade us that we can have our cake and eat it too, we can have no hesitation in stating flatly, "It just isn't true."

We must face up to the reality of either raising taxes or revising our tax structure to produce more revenue or reducing the priorities of

some other programs until we can get things in better balance. Whatever the justifications for deficit financing in time of recession—and at best I sometimes think there is a good bit of wishful thinking involved — there can be no question that when business is improving and moving actively toward higher levels, a budget deficit becomes fuel on the fire of inflation. In effect, it pumps air into the business structure as if it were a balloon and eventually leads to more serious recession when the balloon pops than would have occurred if it had not been indulged in. Again let me say, this is not pleasant, but with due respect to these people who talk about modern times and outmoded classical theories what I am saying is based on time-honored and time-tested principles that are as valid and inescapable today as they have been down through the ages.

Likewise, it is time we stopped shilly-shallying around about this matter of interest rates and faced up to realities. We have had far too much talk about so-called “tight” money and “soft” money without adequate understanding of the role of interest rates in our economy. We already have too many preferential interest rates established by statute as though it were possible to ignore completely the workings of the market place. Interest rates are the prices charged for credit. They are a wage to the saver as well as a cost to the borrower. In a private enterprise economy they are established by the interplay of market forces. They perform the important function of influencing the volume of credit that flows into specific channels of enterprise. They are essential to pricing the assets on which holders expect to receive income over a succession of years. It is through flexible rate movements that the incentives and dis-

incentives are provided for balancing out supply and demand factors in our economy.

The most striking illustration of their usefulness and effectiveness in recent years occurred nearly eight years ago when the decision was made to unpeg our Government securities market. This restored to that important market some of the influence which had been denied it by Government policy for a period of years during which regulation of the money supply gradually became almost ineffective.

Once this decision was taken, the credit mechanism began to function as a governor on the flywheel of our economy and the process of stabilization became a useful part of the adjustments necessary in a healthy economy. We are compelled to recognize, whether we like it or not, that you can alter the nature of demand and change the composition of supply but you can no more ignore the law of supply and demand than you can ignore the law of gravity.

Sometime ago a top industrialist who had complained bitterly about rising interest rates told me he now recognized that some adjustments were probably desirable, but he said, "Don't let interest rates go above 3 per cent." Although there are technical differences between the commodity he is manufacturing and this man-made device of money, I asked him how he would like it if the Government laid down a decree that the product he was manufacturing, regardless of cost and price factors, could not be sold to the public above a fixed price. The only answer I received to this suggestion was "That's different."

Now I want to go one step further and talk about the most difficult aspect of all of our problems. This is the subject of confidence. It is the subject we frequently avoid because

we are afraid of upsetting confidence by discussing it. All of us know of cases of irresponsible and hysterical individuals who contribute to tearing down confidence. We are more likely to recognize them than we are the equally irresponsible individuals who over-paint, over-sell, over-emphasize the optimistic side of things in the name of inspiring confidence. In any event, confidence is perhaps the fundamental factor in money and currency. Those of us who are charged with responsibility for our monetary affairs recognize this clearly. Money must not only be a medium of exchange and a standard of value, but it must be something in which people have basic confidence.

Because of the interrelationships of interest rates and budgets and the present position of the United States in international trade, it is a serious matter when an important segment of world opinion has begun to question the fiscal and monetary integrity exemplified by our American dollar. It is not something we can lightly pass over in hope it will go away. The battle against inflation is at a crucial point, and a setback in the United States would be a serious setback for the entire free world. I would like to be able to stand here and say flatly, "There will be no inflation." I cannot do so. For any one man, that would only be idle talk. What we need now is not talk nor long debate nor lengthy analysis, but resolute actions — continuing over time — which will demonstrate to doubters the good sense and character of the American people.

A pressing need for such action confronts us as we approach 1959. The fear of inflation is earnest, and it is having a damaging impact already. Today, when the level of savings in

our country has been steadily rising, we could, in my opinion, be selling long-term Government bonds at interest rates substantially lower than current levels if the holders of these savings were convinced that there will be no inflation — convinced that we will conduct our affairs on a basis which will make inflation improbable.

I am well aware of the fact that some of these remarks may be interpreted pessimistically. They are not so intended. We have already made a good start on the road to improving this situation. However, the progress we have already made gives no ground for complacency. Improvements in business efficiency effected during the sharp but short recession are helping in the current recovery movement that is continuing on a rather broad basis. And it is not news to any of you that the Federal budget is getting determined attention in more than one quarter. Let us press forward on these sound lines and no one can doubt our success.

The recent trip to which I referred impressed on me as never before that the eyes of the world are on us. Responsible officials in many countries are watching us closely to see whether we intend to practice what for many years we have preached to them. The future is not entirely within our control but we do have it within our power to maintain the integrity of the American dollar if we have the will to do it. Until or unless the people, through the Congress, change the Federal Reserve Act I can pledge to all of you that the Federal Reserve System will do everything in its power to safeguard our currency.

FEDERAL RESERVE BANK
ST. LOUIS, MISSOURI

1959 JUN 11 10 00 AM

ST. LOUIS, MISSOURI

*Additional copies are available
upon request*

MERCANTILE

TRUST

COMPANY

St. Louis, Missouri