

A D D R E S S
OF
HONORABLE WILLIAM McCHESNEY MARTIN, Chairman
Board of Governors of the Federal Reserve System
before the
FREEDOM BOND DRIVE TREASURY-INDUSTRY CONFERENCE
Statler-Hilton Hotel
Washington, D. C.
January 16, 1963

Gentlemen, I am delighted to be here. I looked through the notes that I had for the visit I had a year ago and I noticed that I opened by saying that I didn't intend to carry coals to Newcastle because I have been visiting with this group for so many years that I really have very little new to say.

I looked through that little talk and I am sure I could say ditto to everything I said at that time. But I do welcome the opportunity, although this is the sixteenth year I have been identified in one way or another with this program, to place the Federal Reserve System, the twelve banks, twenty-four branches, and our employees, on record as being wholeheartedly in support of this program.

It is, I believe, as I have indicated, an American program with unique capacity and unique qualities. I think what we are talking about here is that there is no other country in the world that has a program of this sort, and we are emphasizing voluntary savings as opposed to involuntary savings.

Now, I note that some of you think in the Payroll Savings Plan that we do a little bit of bludgeoning, but I can assure you that that isn't the connotation that this voluntary savings program has.

Now, I thought this morning that I would take my time in reporting on progress during the past year rather than going over the comments that I made last year except to reiterate the basic point that if this program is effective and useful, it must be in its essence non-political. The savings bond and the United States dollar which is a part of it, is of importance to both Republicans and Democrats alike and neither party in my judgment benefits by depreciation of the currency. And I think that becomes apparent to any thoughtful individual. And I want to say to this group at this point in the current Administration that I believe that that principle has been very well lived up to during the past year in the program.

I thought this morning that I might just emphasize this in a very simple way, because I know the questions that are in your mind with the tax program by referring to two questions that the President was asked in his talk at the Economic Club in New York, because these relate directly to the problem of the purchasing power of the dollar and maintaining it, and to the answers that he gave. So I am just going to read the answers that the President gave to these two questions and then elicit from you any questions that you might have on them because I don't see how I could have put it better, and it seems to me that this is the heart of what you gentlemen are interested in.

He was asked at that meeting: "Mr. President, in view of the prospect for a deficit in any event and a fairly large one if taxes are reduced, is it part of the Administration's plan to finance a major part of that deficit outside the banking system in order to reduce the threat of monetary inflation?"

And I give you his answer: "That will be a judgment which is primarily that of Mr. Martin, Chairman of the Federal Reserve Board, and the Federal Reserve" -- not Mr. Martin alone. "He has commented on that to a degree before the Joint Economic Committee, House-Senate Joint Economic Committee, this year. He is concerned about the prospect of inflation because, of course, it affects us adversely and also because it affects the balance of payments. I would hope, however, and I am sure that he will agree, that he will, any deficit that has to be financed will be financed in a way which will to the maximum degree possible stimulate the economy without increasing the prospect of another inflationary or speculative spiral. So it is a final judgment which Mr. Martin will make. And I am sure he will be as concerned as all of us are to get the benefit such as it may be out of the deficit and also at the same time keep and use our monetary tools wisely enough to keep matters in control.

"His judgment will be, because of the Federal Reserve law, final."

That is a very heavy responsibility that is placed on the Federal Reserve in that statement and I would solicit your careful recognition of the wisdom that we will have to exercise to handle this matter properly.

Now, I want to just comment a little bit here about this matter of deficits and deficit financing. I don't think any of this group -- there are a good many faces here new to me but others have been familiar to me through the years -- think I am an enthusiast for deficit financing. I am certainly not. I wish we were dealing with surpluses and not deficits. However, I think that under certain circumstances and conditions deficits can be beneficial and can be helpful.

Now, I think all of us, for fifteen years or more, have discussed the matter of tax revision and tax reform and the drag on the economy that has come from it. We come to periods where deficits are inevitable. Now I think that we have to recognize that in all of existence, and I happen to belong to the school that does not believe that the size of the deficit is ever anything to cheer about. I happen to believe, however, that under certain circumstances a deficit can have a galvanizing effect, if it is properly handled and if it is programmed to be removed. I am not certain how great the risk is that the Administration is currently taking with respect to the projected deficit. That is a judgment that all of us will have to evaluate. But I happen to feel that the justification for tax revision and tax reform is a very real one here in terms of incentives that may be provided to the economy in the form of galvanizing people to be doers and savers rather than just sitting idly by and that that is the crux of this matter of tax revision and tax reform.

I think that it is a very difficult political program and I have tried very hard in the Federal Reserve to avoid getting into the political arena as such, though I am not naive enough to believe you are completely divorced from it in the field of monetary management, although I emphasize that depreciation of the currency benefits neither party and is not in my judgment a proper political issue, and I believe that both parties can combine on that point.

Now, I believe that this is the heart of this deficit financing problem and when it comes to the matter of creating money, it is a very difficult thing to explain to people, that we have a managed currency in this country, have had ever since the Federal Reserve System was instituted, and the judgment of the Federal Reserve has been final with respect to what the requirements of the economy are, in terms of the bank reserves required under our system of fractional reserves, for growth, for development of the economy.

Now, whenever the Federal Reserve creates credit over and above and beyond what in its judgment it believes the economy needs and can appropriately use merely for the sake of facilitating Treasury finance, then in my judgment the Federal Reserve has embarked on an inflationary program which can do nothing but dilute the purchasing power of the dollar.

An element of judgment comes into that. I happen to believe that by and large through the years the Federal Reserve, if it has erred, has erred on the side of too much ease rather than too little. That is a judgment that I make. But I don't believe that any central bank will ever follow a specifically deflationary monetary policy. I think you can rest assured of that. The very nature of sound central banking is to not follow a deflationary monetary policy as such.

But I believe we have to recognize that there is an area of growth that is desirable, whether it is 3 per cent, 4 per cent, 5 per cent, 2 per cent. I don't believe you can statistically measure these things. The more I have worked with figures like free reserves, the less confidence I have in them as to their mathematical effectiveness in achieving goals or in achieving degrees of ease or less ease in the money market.

Now, we have been following in the Federal Reserve a moderately easy money policy for the past two years and I am inclined to think that we have contributed about all we can through monetary stimulation to the economy without having money so freely available that it will induce speculation, in the absence of an economy that will sop it up in productive enterprise, and it will be available for foreigners to borrow in these markets and take abroad, unless we have slightly higher interest rates than we have had, and we don't want slightly higher interest rates unless it comes about through the natural requirements of the economy for credit.

At this point I want to make the point that I have never known an economy to be strong and vigorous that does not have a tendency for slightly rising interest rates. I think you can always get easier money and lower interest rates in a recession or a depression. It comes about naturally under those circumstances. I think whenever the Government tries to force these trends in either direction, it gets into trouble because the forces of the market are really too big for the operations of the central bank.

We can influence these trends to a degree but we cannot control or make them.

When we raised Regulation Q a year ago we provided an incentive for savings.

It has not been needed in some instances. And some banks that you know of have reduced the rate from 4 to 3½ per cent because they haven't felt that they could pay it, and that is what they should do if they don't think they can pay it. This was a permissive regulation. As I said to this group a year ago, I think that regulation should be eliminated entirely. That is a matter of judgment. It is in the hands of the Congress, not mine. But I don't really think that it serves any useful purpose today to have a specific limitation on the banking system through Regulation Q. It might under certain particular circumstances have that effect, and it might be necessary, but I don't believe it is at the present time.

So what I think we are dealing with is that where you as an individual deposit money in the bank in a savings account, or where a business does it as a bona fide time deposit, and there is a transference of those funds into Government securities -- and whenever there is any expansion of the banking system there ought to be some transference into secondary reserves in the form of Government securities

or similar obligations -- I believe this is not inflationary at all. I think what is important is that the Federal Reserve supply all the reserves that the economy can use and perhaps slightly beyond that, just for good measure, but that it not get itself entangled again in the vicious circle of creating reserves for the primary reason of making it possible for the debt to be financed easily and at low rates.

Under those circumstances, as I see it, that is the use of the printing press. There is no other way of describing it. And we have this problem today.

I have just been talking this morning to a man on the Hill who tells me that we now have 10.1 billion dollars in the Budget for interest charges for the next year and he said, you and the Federal Reserve won't do anything to lower that cost to the taxpayer? I think we ought to get rid of you and get somebody who would have enough sense to realize that if you really would use the power of the Federal Reserve, you might get that down to where it is 8.9 billion dollars. And any new financing that has to come along would be floated cheaper.

The only argument I could make with this man is the age-old argument that whenever the king found difficulty in carrying the debt that he had incurred, he had a very nice technique that we are all familiar with of clipping the coin, and this is essentially what we are talking about when we are facing that sort of thing.

Now, you gentlemen are in the process of selling the finest security in the world because there is no government with the stability and the standing of the United States Government. There is no question about the repayment of principal and the payment of the interest that is indicated. The only problem is depreciation of the currency. And I think it is up to us in the Federal Reserve, with the help of the Treasury, to do everything in our power to see that we preserve the purchasing power of this currency and I believe during the past year we have been reasonably successful.

You can never measure these things precisely and say you have done it right down to the last decimal point, but I believe we have been pursuing a proper course to preserve the purchasing power of this currency, and therefore you are justified in your sales effort to sell these savings bonds. I believe that is important and I think it is vitally important that, regardless of what comes out of any deficit that may come about from short fall in the economy or from additional Government expenditures or from a tax cut, it be financed in large measure through bona fide savings and not feed the printing press. That is the simplest way I can state this problem.

I think the President recognized this in this statement. There is an element of judgment in it and I can assure you gentlemen that never at anytime is it the desire or purpose of the Federal Reserve to throttle or restrain the economy. The role of the Federal Reserve is, as is the rest of the Government, to foster and promote free competitive enterprise.-- these are the words of the Employment Act -- and at the same time to promote maximum production, maximum employment, and maximum purchasing power. These are our goals. And I think you can summarize those goals under one heading of orderly and vigorous economic growth.

Now I think -- again I want to reiterate -- that I am not proposing or supporting a tax cut as such when I talk about this. I am trying to leave that to the Treasury Department and the legislators. But I am emphasizing the fact that it is not an open and shut case. Some people like to brag about the size of the deficit that is going to be created. I don't happen to belong to that school. But I want to say to you that I believe insofar as there is real justification, and

I think there is, for consideration of the need for tax revision and tax reform, that it comes down to the simple point of whether we are encouraging people to do and to save because both of those are important to the economy, and I believe after 15 years of wrestling with this, I happen to be glad to see that the Congress and the Administration are tackling this problem of tax revision and tax reform because I believe we do need to encourage people to do more than they have been doing and to save more.

I think that we have had an adequate level of savings but it is out of growth financed by bona fide savings that the real future of the country lies.

Now, I will make one other comment, and I quote again from the President here. He was asked: "Mr. President, will it be possible and desirable to use a little easy money stimulation as well as tax reduction?"

The President answered this way: "Well, I think there is a good supply of credit. I think the Federal Reserve Board has attempted to keep credit as free as it could and the supply of money has been increased with the growth of the economy. I think it would be very difficult to keep it easier than it now is without having the short term funds pour out at a higher rate than they are.

"After all, we have seen when Canada put its interest rates up, I think as high as 7 per cent, it affected the flow of capital here. In October we had several cases of major investments using our markets because of our interest rates. The fact of the matter is that I am not sure that we could get much stimulation out of the economy but I don't see how we could possibly afford easier money than we now have and still not have a hemorrhage at our balance of payments.

"I think we have a major problem to balance off the use of the monetary policy here at home affecting our balance of payments abroad and also that is one of the good arguments, and as a matter of fact I think we can make the case, which is almost unanimously made in Europe, that the United States monetary policy in some ways is too loose while our fiscal policy is too tight, and it is for that reason that the international banks of Europe and others have suggested that the reverse would be more appropriate. I think we should attempt to keep monetary policy about where it is, try to liberalize fiscal policy for the reasons that I have given tonight, but I don't see how we could possibly go any further in the direction of easier credit while we have a balance of payments which is against us by over \$2.5 billion a year."

I don't believe I could have stated it as well as the President has stated it.

Now, that isn't a statement for all time and I think we have to think about this thing. Business activity is one of the keys to easier or less easy money. Under present conditions I don't like to use the term "tight" at all because I think it is a matter of easy and less easy money that we are dealing with. But I believe we have had relative stability in interest rates for quite a period of time here and I believe that has been beneficial to the economy and beneficial to you gentlemen, and let me say here that we could not have done what we have done without the complementary debt management support that we have had.

In the matter of short and long term areas, the composition of the debt, we have had the closest relationship between the Treasury that I have had at any time since I have been with the System, and we have worked very effectively with Mr. Roosa and his associates and the Federal Reserve Bank in New York, to see to it that we could get the maximum benefit out of the coordinating debt management and monetary policy.

Now, they are two fields that are closely interrelated. One of my critics on the Hill used to say that good fences make good neighbors and what we ought to have is a line between monetary policy and debt management policy. I used to always reply to that by saying that good fences do make good neighbors, but if you are going to be good neighbors, you need a door to go through the fence. I think it has been generally recognized that primarily the field of monetary policy belongs to the Federal Reserve. Primarily the field of debt management belongs to the Treasury. But the two of them must work together carefully. That door must be swinging back and forth.

I like to think of a revolving door, if it is to be useful and effective. I think we have had that and I believe it has contributed a great deal to the success that I believe we had during the past year.

Now, as to the future, no one has a crystal ball but I believe the economy has performed surprisingly well, better than I thought it was going to perform at certain points. I think we have been subject to a great many predictions of one sort or another but I believe that we have done better than we have done for some time because the American business community is recognizing that the fundamental correction of the balance of payments is the ability and capacity to compete. And I believe that real progress is being made by business in certain areas on this.

I believe our automobile industry has been doing an exceptional job and been fortunate. A year ago this time I stressed the point that during the 50's the consumers and the savers were the forgotten men and that I happened to believe still in the Golden Sixties. They may not be the soaring sixties, but I still believe in the Golden Sixties and I believe the consumer and the saver are coming into their own in the sixties. And I still think that the prospects are very bright indeed.

Now, we should do everything we can within the area of proper emphasis to provide growth and development, and encourage things that we all want for a better life, but I think we must not compartmentalize these programs. I think that reducing unemployment, promoting growth, and establishing equilibrium in our balance of payments are essentially one and the same problem. I don't believe it is the type of problem that you first work on a program for reducing unemployment and then you work on a program to promote growth and then you work on a program to improve the balance of payments. I think it is one and the same problem, and unless we recognize it as such, we may not achieve any of the goals that we are all so eager to achieve.

I want to say to this group that I for one am very much encouraged with the progress that has been made in the past year without in any way minimizing the difficulties that are still ahead of us, those with respect to the balance of payments and with respect to Federal finance. But I believe that with the support and help of a group such as this, we can look forward to overcoming these obstacles, and when I think of the obstacles that we have overcome in the last ten to fifteen years when periods have looked rather blue, I can't help but close with a note of real optimism and encouragement.

Thank you all for letting me be here.