## Maintaining the Value of Our Money

In a world strained by tensions, we are fortunate to live in a country that has consistently responded to peril with greatness. A savage bombing attack on U. S. soil almost exactly 20 years ago did no more to halt the progress of the American people than attacks by bow and arrow two centuries earlier.

We are a strong and a resourceful nation, with a role to play in maintaining freedom and civilization in a beleaguered world, and we are able now, as in the past, to meet whatever needs may come upon us. That is so in large measure because we have an economic system of great strength and even greater potential, founded on the principle of freedom of enterprise and individual initiative.

It is not my purpose tonight to engage in predicting economic levels: already there are estimates aplenty, in a wide range of sizes. My concern, instead, is with how to get the most and the best out of the American economy. But I would like to note that, in appraisals of the basic strength and potential of our economic system, there seems to me to have been a decided tendency for many years to underestimate rather than to over-estimate.

Over the past year we have had both recession and recovery, and now we are embarked upon an expansion that already has carried almost all indicators of overall economic activity to heights well above any we have ever attained before.

It is, nevertheless, imperative that further progress be made: too many people are still unemployed, too much of our business structure is still operating below most efficient levels, and our growing population must have more job and business opportunities.

To that end, let us take note of an important change that has occurred in the economic atmosphere of the world around us, for it is something we must take seriously into account in considering our own course for the future.

I think it no exaggeration to say that--apart from matters bearing directly on the question of peace or war--the most important single development of recent times has been the entry of the world into a new era of vigorous economic and financial competition.

This is not a new fact, of course: it has been in the making for years as, with a generous assist from us, the countries of Europe cleared away the ruins of war, got their finances in order, developed an industrial base unprecedented in size and efficiency, expanded their foreign trade, moved from debtors to creditors, and opened the way for a freer international flow of funds by restoring the convertibility of their currencies.

In a parallel development, the United States balance of payments with the rest of the world dropped from a surplus to a deficit position, reflecting the fact that the United States was spending, lending, and investing more abroad than foreign countries were spending, lending, and investing here. The deficits began showing up 12 years ago, and, save for one exceptional year, have continued since. This constitutes a problem we dare not overlook and cannot ignore.

Slowly we are all coming increasingly to understand that in industry, commerce, and finance alike Americans are in competition not only with each other but also with the world; in competition not only for goods and services but also for capital funds; in competition not only in design, quality, promotion and credit terms but also in prices; in competition not only as sellers and lenders but also as buyers and borrowers.

All this brings strains, but it also brings opportunities. An increased international flow of goods, services and capital is mutually advantageous to all participants, and expanding that flow can benefit us as well as the rest of the world: with Europe more prosperous, and with Latin America, Asia, and the old and the new countries of Africa striving for better standards of living, opportunities for us to market our goods also are broadening.

To meet the competition of the world, which we are feeling with mounting intensity even in our domestic markets, we need the traditional American virtues of initiative, imagination, inventiveness, enterprise and managerial skill in order to come up with the right goods and services, at the right places, in the right times, and at the right prices.

But we also need a quality for which we have not thus far distinguished ourselves--and that is the quality of self-discipline. By that I mean self-discipline in our private and in our governmental processes alike.

We simply cannot afford to be priced out of the market by the wage-price spiral: in our private enterprise, employers must realize that they are competing with other employers around the world for sales and profits, and employees must remember they are competing with other workers around the world for jobs as well as wages.

Neither can we afford to be priced out of the market by currency inflation: in our governmental operations we must earnestly avoid budgetary and monetary practices that can undermine the value of the dollar, and so undermine our competitive position as both sellers and buyers of goods and services throughout the world.

In short, there is mutual need of an urgent nature for labor, management and government each to measure up to its separate responsibilities, and at the same time to refrain from behavior that makes it harder for the others to measure up to theirs.

Having given you this broad picture of things as they seem to me, I want to take this opportunity to record my views on where the Federal Reserve fits into that picture, even though I don't think I can add anything new to what I have said many times over since I entered upon my present duties, more than ten years ago.

In our free society, the responsibility of government, as I understand it, is not to order the lives of people for them but to provide them a climate of opportunity that will encourage them to apply their energy, enterprise, and ingenuity to bettering the lot of themselves, their families, and their communities, and thus to promote the welfare of the country as a whole.

That general responsibility is one in which the Federal Reserve System shares. The direct responsibility of the System, at all times, is to provide monetary and credit conditions that will encourage business and employment, safeguard the value of our dollar, and promote sustainable growth in the economy. By so doing, it can make an important contribution to improving the living standards of the people as a whole--though it can never do more than that because its powers are limited to credit matters, and business and employment do not live on credit alone.

Clearly, the framers of the Federal Reserve Act were aware that monetary policy would inevitably require an element of judgment. For they took what seem to me some very wise precautions to see that the required judgments would be, in so far as human capacities permit, impartial, informed, and in the interest of the country as a whole.

Great care was taken, when Congress entrusted the power of money management to the Federal Reserve System during President Wilson's administration nearly half a century ago, to safeguard that power from becoming a device that could be controlled either by private interests, on the one hand, or political interests on the other. The framework of the System was designed to reflect in the best American tradition a blending of the public interest and private enterprise, and also to accord recognition to the wide areas of the United States and the local and regional problems that arise out of peculiarly American conditions.

That is an important as well as a unique advantage of the System, as becomes evident when we consider what is required in formulating a program to provide credit and money conditions properly attuned to the economic needs of the day, and of the morrow as well. The first requirement is a painstaking search for all the relevant facts that may bear upon the economic and financial outlook. The next is interpretation and appraisal of those facts. There are of course other requirements less tangible but not less essential. One is consciousness of certain principles that underlie and sustain the American system, to which I have made brief reference. Another is humility--or perhaps I should say an awareness that no man can unerringly foresee the future, and therefore he will do well not to act as if he could.

All these matters are part of the background of monetary policy decisions. Perhaps I should mention as well some basic considerations that enter into making the decisions themselves. The first consideration is to estimate the financial needs of the general economy--the private sector, as represented by industry, commerce, agriculture, and consumers, and the public sector, as represented by the Federal, State, and local governments. The needs of these sectors are intertwined, but they can be separated for purposes of discussion.

The United States Treasury, as the financial representative of the Federal Government, has the task of raising the money needed to pay for the expenditures that are authorized by Congress and made law with the signature of the President, as it also has the task of managing the public debt accumulated in that process. The Federal Reserve's operations in the money field must be conducted with recognition of the Government's borrowing requirements, for two reasons: first, although the Federal Reserve has no part in tax or expenditure decisions, it does have a duty to prevent financial panics, and a panic surely would follow if the Government, which represents the people as a whole, could not pay its bills: second, it would be preposterous for the Federal Reserve to say in effect that it didn't approve of the expenditures authorized by the Congress and ordered by the President, and therefore it wouldn't help enable the Treasury to finance them.

So, seeing to it that the credit base is large enough for the Treasury to borrow whatever is needed to pay the Government's lawfully incurred bills is an obligation binding upon the Federal Reserve. On the other hand, there is a reciprocal obligation on the part of the Treasury to conduct its operations with recognition of the Federal Reserve's responsibility for orderly credit and economic conditions, and for stability of the dollar. The Treasury obviously would not expect the Federal Reserve to inflate the money supply, thereby putting the entire economy in jeopardy, merely so that the Treasury could get money at an artificially low rate. So, with complementary responsibilities, the Federal Reserve and the Treasury must work together in complementary fashion. Neither can ignore the forces of supply and demand that are reflected in the market place and attempt to dictate what interest rates should be. Instead, both must assess market forces and determine their policies accordingly.

Now, as to the needs of the private sector of the economy: the credit needs of business--including agriculture--characteristically expand at certain seasons, and it is always the job of the Federal Reserve to see that these seasonal needs are met. The Federal Reserve has always done so, and will keep on doing so. It is one thing for interest rates to rise under the pressures of a heavy demand for credit, and another thing for money to become generally unavailable. The forces of the market must be allowed to operate, and to be reflected in interest rates, but it would be fantastic for the economy to be stifled by unavailability of credit. Because this is a vast country, money may be less available in one area than another for limited periods, but it is up to the Federal Reserve to see that the seasonal requirements of business are met.

A third factor that requires consideration in determining monetary policy is that of growth. The volume of money must grow with the growing population and the growing scale of economic activity and productive capacity, so the base of bank reserves must be expanded accordingly. How much growth there should be is more difficult to say. I do not profess to know what the figure ought to be, and I doubt that a precise figure can be set as desirable for year-in-and-year-out purposes.

In the matter of growth measurements, one needs to be extremely careful. Growth in the money supply must be related to the country's real needs. At any time that borrowers crowd banks with loan demands on a scale much greater than can be judged reasonable for growth needs, they can expect the result to be some rise in interest rates. If that rise does occur, it merely signals continuance of the Federal Reserve policy of letting the supply and demand for credit be reflected in market rates of interest. Certainly it does not signal a policy of choking off the flow of credit and forcing rates artificially higher, for there is not any such policy and there is not going to be one of that kind.

Still another factor that we have to deal with is psychology, or to use the economists' jargon--expectations--and no reliable yardstick has yet been devised to measure this factor. What things really are may count most in the long run, but what often counts in the short run is what things seem to be--what people think they are. I recall instances over the years when we were proceeding to provide for a rate of growth in the money supply that, even in retrospect, seems to me pretty close to perfect. But even if the calculations were right in fact, they were on occasion wrong in the scales of psychology. And what counted was not what the facts were, but what people thought they were or were going to be.

Now, let us take a look at what the Federal Reserve has been doing in recent times to keep credit conditions attuned to the needs of a nation caught in a cross-fire between domestic and international problems.

On the domestic front, to help bring about recovery, expansion, and sustained growth in production and employment, the Federal Reserve has been operating to make sure that the banking system can meet every reasonable borrowing need.

On the international front, to help hold down the outflow of capital and gold prompted by the continuing balance of payments deficit, the Federal Reserve has been operating to see that the outflow is not aggravated by the [illegible] ~~pull~~ of international differentials in interest rates.

The domestically oriented operations began nearly two years ago, when the Federal Reserve moved early in 1960 to try to buttress the economy against weaknesses that were to become increasingly evident after mid-1960 and bring about the short but painful recession that carried through to early 1961. These operations were extended as the recession deepened, then maintained through recovery into expansion.

In the course of pursuing these operations, the Federal Reserve made possible over a period of 18 months since May 1960 a $20 billion growth in the deposits of the commercial banking system, after adjustment for seasonal variation--$15 billion of it in time deposits and over $5 billion in demand deposits. These increases represent annual rates of expansion of 8 per cent in total deposits and 3 per cent in demand deposits. These substantial increases in the spending power, actual and potential, of the American public provide a monetary base for the economy's advance to heights far beyond anything yet seen. Yet the total volume of deposits is not high relative to the level of economic activity currently existing, not to mention the potential for further growth represented by unused resources. Continued bank credit and deposit expansion will be needed without incurring risk of excess, although perhaps not at the same high rate as was appropriate in the last year and a half of economic recovery from recession.

The internationally oriented operations began in October 1960, and were extended in February 1961, as the Federal Reserve's open market transactions in Government securities for the purpose of providing bank reserves were broadened, first to include securities with a maturity up to 15 months, and next to include all maturity sectors. Until October 1960, these transactions had been confined, with few exceptions, to securities with a maturity under one year.

By spreading the direct impact of Federal Reserve purchases over a wider range, these operations exerted some influence, supplementary to the much more important steps taken by the Treasury, in holding short-term rates at around the 2-1/2 per cent level despite the decidedly easy posture of monetary policy. Some assistance was thereby rendered in keeping short-term capital in this country. If these funds, looking for higher interest rates abroad, had moved outward in greater quantities, our international account imbalance would have been made even more serious.

Now it is not my purpose either to apologize for or to boast about the Federal Reserve's operations, on either of these fronts. What I really feel is that the System has made an earnest effort, and I believe a constructive one, to do its part in dealing with national problems of diverse character. But I would not want to deceive you, or myself, by claiming victories that have not yet been won.

Of one thing I am quite sure: we cannot make solid progress on a shaky foundation. And the possibility of getting the most and the best out of the American economy is going to be lost if we delude ourselves into thinking that we can substitute gimmicks or short cuts for hard work and honest values.

Much concern is centered these days on whether the consumer will expand his buying and thus clear the way for more production and more jobs, in growing number.

Well, consumers now have more income and considerably more savings than they have ever had. Would it be too old-fashioned to think that the solution may lie in trying to offer the consumer more for his money? All we'd have to do would be to let the consumer share in the benefits of increasing productivity--an undertaking that could be facilitated if Government, management and labor would work together to hold costs down all around.

In our external, as well as our internal economic and financial affairs, much the same questions arise. Does anyone think we'll be better off in our international accounts, or even as well off as now, if American products become more expensive abroad, and the American dollar becomes cheaper, either as a result of the wage-price spiral or of currency inflation, or both? What if, instead, we put our minds and hearts into convincing the whole world, by performance, that the value of American products and of American dollars will always equal or better that of other countries' products and currencies?

In any event, it seems to me we have no choice but to make the try or else resign ourselves to eventual decay. Does anyone truly feel our country's reputation as a safe haven for short- and long-term investment funds can interminably withstand the sort of deficits in our balance of payments we've had so persistently in recent years? Does anyone seriously believe we can indefinitely avert a damaging drain of capital and gold resources except by taking actions to eradicate the fundamental causes?

Is it too much to expect the richest society the world has ever known to get its income and expenses enough into line--in one way or the other--so that it isn't perennially passing out IOU's in lieu of paying its bills?

Let me say right here that I don't think anybody here or abroad questions the ability of our country to "afford" whatever amounts it needs for the national defense and for the social benefits the American public demands as well. But I think there are a great many who question whether we can afford indefinitely not to pay--willingly--the costs we willingly incur.

Budget decisions are always hard to make, especially when exceedingly costly measures are rendered imperative to protect the nation against an unparalleled threat of total destruction. Our present budget troubles come not nearly so much from decisions made in this or in any other single year--even fiscal 1959 with its peacetime-record deficit--as from the fact that we have shown budget deficits in 25 of the last 31 years, many of them prosperous years in which a surplus would have been more logical to expect.

Since 1946, the dollar has declined in value to 65 cents. That suggests the dimensions of the job to be done in the future. It also makes the job itself more difficult, and more urgent. The resultant higher level of costs makes it harder not only to maintain our competitive position in the world, but also to retain worldwide confidence in our ability and will to maintain the dollar's value henceforth. Dollar erosions, like nuclear blasts, leave behind cumulatively poisonous effects.

In my view, it would be grossly unfair and wholly unfruitful to blame any one Administration for our national debt's growth and our currency's shrinkage. Deficit financing has marked many Administrations, and the emergency of war has forced it on many of our presidents, with inflationary consequences they could not prevent. From its founding, the United States has had 34 presidents and I am certain none of them has ever <u>welcomed</u> a deficit or <u>advocated</u> inflation as an instrument of policy. If we the people want a culprit, we had better look for fault in ourselves, as well as in somebody else. And we had better give a collective assist to Presidential commitments to balanced budgets, whenever they're proffered. The least thing we can do for our country is to stop asking it to do more for us.

My observations tonight on the need to maintain the value of our money have not come from feelings of despair. I have been prompted, instead, by belief that in a democracy, where the ultimate responsibility for policies rests with the people, any observations on matters of national concern have some chance of serving the public good.

The integrity of the dollar is not a political matter. Otherwise, it could not be a topic for discussion by anyone in my post: it is my deep conviction that a central bank--which must always assist incumbents but never candidates--must not, in any time or place, be engaged in partisan politics.

It is important to remember that when we deal with the subject of money, we are also dealing with the faith and credit of the United States.

As a recent trip has reminded me, to people abroad, much more than to Americans, the dollar is a symbol of this country's strength. Thus, a decline in the value of the dollar, to say nothing of a formal devaluation, would suggest to them a decline in the faith and credit of the United States, and in their minds signal a decline not only in American economic strength but also in moral force.

But money has more than a symbolic value. In functioning as a medium of exchange, as a standard for measuring value, and further as a means of storing value, it serves--so long as it is kept stable in value itself so that it may perform those functions--to keep our entire economy functioning efficiently for the maximum benefit of all.

There is still another aspect of money we should never forget. And that is that money--if good--is an instrument of liberty. As we know from history, it was not until payment in labor and produce was supplanted by payment in cash that men were able to break the bonds of serfdom that had bound the mass of them for life to their native plot of soil and their native status in society.

Money gave men freedom of movement and of leisure. It gave them the ability to change the nature and place of their work and the locality of their possessions at will. It gave them freedom to do as they pleased with the product of their labors; to eat it or to drink it, to give it to a church or charity, to spend it for learning, to save its value against some unforeseen event, to use it to raise living standards for themselves and their families, or to put it aside to fortify their independence when they wish to assert it.

For these, and for many other reasons, money should never be a political issue. There are numerous, legitimate areas of difference between the parties on matters of both theory and practice on which the voters are divided by their convictions or interests. But in my judgment, it is clear that the necessity to maintain the integrity of our currency is accepted by the rank and file of Democrats and Republicans alike, and that neither party can benefit by depreciating the dollar.

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