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The Balance of Achievement

Remarks of Wm. McC. Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

at the

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of the

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THE BALANCE OF ACHIEVEMENT

I am very pleased to receive this William Penn Award from the Chamber of Commerce of Greater Philadelphia. In accepting, however, I fully understand you are according an honor to the great American institution I am privileged to serve. This is appreciated. For, unless the Federal Reserve System has the interest and understanding of organizations such as yours, it cannot hope to fulfill its mission.

To be honored in Penn's name is a fine distinction, for it recalls a heritage with which we should all be familiar. William Penn took title to new land in America in 1681 as settlement of a debt owed his father by Charles II. He saw his objectives clearly and moved toward them with dispatch.

He made his peace with the Indians; he carefully laid out his "greene country towne" between the Schuylkill River and the "great River Delaware"; and he established a prosperous and growing community that is, 280 years later, still prosperous and still growing. We can all appreciate Penn's foresight and executive abilities.

But much has happened since the end of the 17th century when Philadelphia was proudly described to prospective colonists as having "two thousand houses, all inhabited: . . . three fairs every year, and

two markets every week." This city and this country have grown larger, and the world has grown smaller, than any of the early settlers could have possibly imagined.

With growth and progress have come new difficulties and new dangers. The difficulties we face today are at least as great as those faced by William Penn on the "old" frontier. But they seem, out of growth and progress, to have become vastly more complicated.

We are faced with a need for a careful balance of conflicting desires. We have many needs and limited resources to satisfy them. This need for balance seems to pervade our lives. The individual strives for balance between work and leisure, between professional and social contacts. He, himself, through mind and heart, is the balancing mechanism. As a nation, we find it useful also to balance conflicting pressures. The checks provided by co-equal branches of Government help us to do this.

In the economic sphere, the free market may be looked at as a balancing mechanism. The free market works to bring about adjustment in demand and supply of goods and services. It is indeed to the credit of the free market that it performs its functions so well.

No more appropriate example of need for balance in the economic sphere can be found than in our international payments position. Over the past several years we have experienced a serious deficit in our balance of payments. The Federal Government spends abroad for military and foreign aid purposes. Private businessmen invest abroad to take advantage of low costs of production and distribution and profitable markets. Businessmen and consumers purchase abroad to take advantage of low prices and new products. We have not been able to induce foreigners to spend and invest as much here in the United States. And yet it is clear that if the Federal Government, private businessmen, and consumers are to continue satisfying their expressed desires to the extent they have, we must increase spending and investing by foreigners in the United States.

During 1960 the balance-of-payments problem was intensified by an outflow of short-term capital. One cause of this outflow was the difference in short-term interest rates in this country and short-term rates abroad. In payment of part of the deficit, gold flowed out of the country at a rapid rate. A continuing accumulation of foreign claims on American dollars, and the outflow

of gold, reached the stage where the stability of the American dollar was being questioned in foreign financial centers. The situation had become critical.

Yet it wasn't possible to concentrate all our policies on this one critical issue. Bringing balance to our international payments is necessary; but we have other desires as well which are closely related and which must, to as large a degree as possible, be satisfied also.

The intensification of our balance-of-payments difficulty in 1960 coincided with a decline in business activity here in the United States. Early in 1960 the Federal Reserve had launched a vigorous program to buttress the economy. The lending capacity of our banking system was expanded by increasing bank reserves and enabling banks to pay off borrowing. With the increased availability of credit, interest rates declined.

The need for recovery at home and equilibrium in our payments internationally confronted the Federal Reserve, as well as the nation as a whole, with a difficult dilemma. Supplying bank reserves by concentrating on Treasury bills in our open market purchases, as had been our general custom, could drive short-term interest rates so low as to encourage a further outflow of funds.

We had, then, to try some other approach to permit the fulfillment of our international and domestic needs in the monetary area. The System decided to push out its open market purchases beyond bills

and other short-term securities to try to provide the reserves necessary to stimulate business without fostering the further outflow of short-term capital.

The cause and effect of economic developments are never easy to disentangle. And we cannot trace definitively the impact of Federal Reserve policy. But for the time at least, speculation against the dollar has diminished; and, at home, recovery has proceeded at a rapid rate since February of this year.

Despite these improvements, we can by no means relax. The basic causes of our balance of payments deficits are much broader and deeper than interest rate differentials. Recovery here in the United States has brought with it an increase in imports, a shrinkage of our export surplus and a growth in our payments deficit. Our deficit, after declining below \$2 billion on an annual rate basis in the first half of this year, increased again to an annual rate of over \$3 billion in the third quarter. A continuation of this kind of deficit is threatening to say the least, and raises the spectre of renewed speculation against the dollar.

We have come, then, a long way from the situation of the early postwar years. During those years, you might recall, we gave generous aid to the war-devastated countries of the world. They did the work of reconstruction; we supplied some of the materials and tools.

In the course of time, our aid program bore fruit. The war-torn countries began to prosper; they got their finances in order, expanded

their foreign trade and created the means and opportunities for a freer flow of funds across their borders.

All these developments were properly hailed as necessary and desirable. But they also marked a change in our own role in international affairs -- from one whose primary purpose was to help restore and reconstruct to one who must now compete.

We have not yet adapted ourselves to this change in status. Consequently, we have not yet achieved a reasonable balance in our international payments. And, as a result, we must continue to exercise care in our judgment of what to do about it.

Some remedies that are recommended could prove extremely destructive. Restrictive trade and investment policies would wipe out the hard-won gains of years of effort to promote trade. Ultimately, these policies would also compound our international payments difficulties. It must be remembered that free and expanding trade is a benefit to us as well as to the rest of the world.

We must, if we are to solve this problem, clearly recognize the kind of world in which we now live -- a relatively small, competitive neighborhood where it takes about six hours to transport 125 people to Europe in one of our jet planes and no time at all to transfer \$125 million by cable. We must come up in foreign, as well as domestic markets, with the right goods and services, at the right prices. Whatever the controversies about other undesirable aspects of inflation, the fact

remains that we simply cannot afford to be priced out of world markets by price increases at home. Employers here are competing with employers abroad for profits. Employees here are competing with employees abroad for wages. This is the meaning -- the problem and the great advantage -- of international trade and the convertibility of currencies. Those who believe in the competitive system, and understand its advantages, should be aware of this.

So, too, with the other economic problems we face today. If we are to achieve our goals, we must pursue carefully considered policies. The Federal Reserve has worked to foster recovery from recession in both output and employment. In November, more than 67 million people were at work, a record number for that month. Yet 4 million were still unemployed. On a seasonally adjusted basis, the rate of unemployment dropped considerably in November to 6.1 per cent of the civilian labor force from the 6.8 per cent that had prevailed over most of the year. That is some progress, but considerable further progress is imperative, and appropriate policies on the part of Government and of labor and management will be needed to achieve it.

When World War II ended, many were concerned about a resumption of the Great Depression. With the waste and sadness of the 1930's in mind, we adopted as a primary objective the maintenance of high levels of employment. When it became clear that the major problem was not depression but inflation, we found it necessary to turn

our heavy artillery in the other direction and restrain excess demand. More recently, much attention has been given to the problem of economic growth. And, as I have already mentioned, our balance of payments today also requires serious attention.

It is sometimes asked whether our multiple objectives are compatible. Can we have high levels of employment and rapid economic growth without inflation and without disequilibrium in our balance of payments?

I think this is not quite the right question to ask. It assumes we can attain one or more of our goals if we forego the others. I doubt that this is true. If we permit prices to rise rapidly, we will not long sustain high levels of employment nor high rates of growth and we will not be able to establish equilibrium in our balance of payments. Conversely, if we permit high levels of unemployment to exist, we also, I think, cannot long sustain rapid growth, or price stability; nor, for that matter, free and expanding world trade. In other words, we must make our objectives compatible by a policy which recognizes our limitations, because if we don't we may find we cannot secure any of them.

What is needed, in my judgment, is a judicious blend of specific actions, well-balanced monetary and fiscal policies by Government, and wage-price policies by labor and management fitting to a vigorously competitive market structure.

In such a setting, the Federal Reserve System would be able to carry out its operations more effectively, and at the same time with greater moderation in respect both to easing and to tightening credit conditions. In consequence, swings in interest rates and in bond prices could likewise prove more moderate.

A good volume of savings is, of course, essential to provide investment funds for enlarging our productive capacity. The role of a central bank, in a period of expansion, is to minimize the tendency for bank credit to be used instead of savings for this purpose. If we are to have the growth and the expansion of job opportunities that we all want, we will need to encourage savings.

In all times, it is of course vital that the nature of our difficulties be studied carefully and that policies be based on sound analysis. If we are to achieve the kind of balance necessary, a rational attack on these problems must be made.

Complete, 100 per cent agreement can never be hoped for. Monetary policy, I decided some time ago, can never be an exact science, for it deals, ultimately, with people, as well as their assets and liabilities. The framers of the Federal Reserve Act were aware, I think, that monetary policy would inevitably require an element of judgment. They took some very well advised measures in mobilizing the efforts of many potential contributors. The hope was that judgments

would be impartial, informed, and in the interests of the country as a whole.

Let me just note one or two of these measures in passing. The Federal Reserve System was designed to promote the public interest. The Reserve Board in Washington is clearly a public body. The members of the Board of Governors are appointed by the President of the United States with the consent of Congress. They have primary responsibility for coordinating and directing policy. The twelve regional banks also play an integral role in the formulation and implementation of policy. They are directed by a board composed of nine directors. The member banks in each district select six of the nine, with the other three being selected by the Board of Governors. Once these directors become members of a Reserve Bank's board, they take on public responsibilities. For example, they initiate changes in discount rates, which must be approved by the Board of Governors, and they nominate the chief officers of the Reserve Banks, who also require approval by the Board. The Presidents of the Reserve Banks join with the Board in formulating open market policy. When Congress entrusted the power of money management to the Federal Reserve System, it endeavored to provide that this power would not be controlled by private interests on the one hand or be subject to political manipulation on the other.

In adopting that approach, the Congress seems to me to have been very wise. Because 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.

When I was overseas recently, one thing that impressed me, more than ever, was how much people in other countries look on the dollar as a symbol of this country's strength. To them, a decline in the value of the dollar, to say nothing of a formal devaluation, would mean a decline in the faith and credit of the United States. They would regard it as a sign of decline not only in American economic strength but also in moral force.

But money has more than a symbolic value. It serves as a medium of exchange, as a standard for measuring value, and also as a means of storing value. In so doing, it also serves -- so long as its own value is maintained -- to keep our entire economy functioning efficiently for the maximum benefit of all.

Furthermore, we should never forget that money -- if good -- is also 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 out of the serfdom that had bound the mass of them for life to their native plot of soil and their native status in society.

For these, and for many other reasons, money should never be a political issue. There are numerous, legitimate areas of difference between the parties -- foreign policy, the limitations of Federal power, the prevention of monopolies and other 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 value of our money is accepted by the rank and file of Democrats and Republicans alike, and certainly neither party can benefit by depreciating the dollar.

In carrying out its non-partisan role, the System is additionally fortunate in having a framework, provided by Congress in the Federal Reserve Act, that was designed to accord recognition to the great diversity of conditions and problems to which our vast continent gives rise. The directors and the personnel of the regional banks -- intelligent, experienced, and well-posted men -- are strategically located. They provide the System with a distant early warning system -- a "dew line" -- in the economic sphere.

The individual Reserve Banks, in their closeness to developing regional situations, also give the System a flexibility it would otherwise lack. The problems of one region today may be the problem of another region -- or all other regions -- tomorrow. The analysis, efforts, and experience of a Reserve Bank in meeting the problems that it perceives could prove of utmost value for other regions and for the nation as a whole.

One of the great challenges confronting all of us today is to improve economic understanding. The Federal Reserve Bank of Philadelphia is about to embark on a new venture to meet this challenge. The President of the Philadelphia Bank, Karl Bopp, will tell us more about this later.

I think you will see that what the Philadelphia Bank is doing is an example of the benefits of a regional system.

The balance of public, private, and regional interests reflected in the framework of the System seem to me in the best American tradition. Democracy is always a balancing of conflicting interests and opinions. We permit and solicit the expression of differences in order to take advantage of the best possible ideas. It was Justice Holmes who pointed out that the competition of freely expressed ideas is not unlike, in its benefits, the competition among goods and services in the market place. We organize for free expression, for the adjustment of conflicting opinions and, finally, for cooperation. "The highest and best form of efficiency," Woodrow Wilson believed, "is the spontaneous cooperation of free people." It is the kind of cooperation that only a democracy can generate.

The economic process of building, producing, and consuming is a rational process. Men can master it through reason, and improve it through the discipline of objective study. If we are to achieve a wise and efficient balancing of policies and objectives in the complex world closing in upon us, the widest sort of understanding is necessary.

Consequently, it has been helpful to have discussion and debate, and critical studies of monetary policy. However, I hope, by now, that it

is widely understood that economic problems cannot be solved by simple mechanical formulas, any more than monetary policy can be formulated by the wonderful machines that have today become invaluable aids.

The winds that carried the news of new worlds to William Penn and others carried also the scent of opportunity and freedom. We have made much of our freedom and opportunity in the virgin continent uncovered a short four and a half centuries ago. Our rewards have been substantial.

What began as a faith in the ability of men to govern themselves without producing anarchy and to fulfill their own ambitions without economic disaster has been confirmed by our growth and progress. We now understand that man has, and always had, tremendous energies for either constructive or destructive enterprise. Our free systems, providing opportunities for success, as well as failure, have through a dynamic equilibrium of desires, channeled these energies into constructive achievement.

If we are to continue our advance, the problems of today, more complicated though they be, must be understood and the balance of what we can have -- given what we do have and what we want -- must be struck. This is no easy task. But with our economic and political heritage no one can doubt our success.