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Our American Economy and the Federal Reserve System

Remarks of Wm. McC. Martin, Jr.,
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No activity is more important than education, and no part of education is more essential than that you are seeking to foster: understanding of the world of business and the nature of the economic process--the process by which people make their living. Those of you who have participated in the vital undertaking of this Workshop on Economic Education deserve the commendation--and the admiration--of us all.

In large part, I have come here to learn, to learn about you and the work upon which you are engaged. I am grateful to you for that opportunity. In my turn, I should like to contribute something to your undertaking, if I can, by making some observations about our economy and the role played in it by the Federal Reserve System, which this year is observing the 50th anniversary of the beginning of its operations.

It is not my intent tonight to engage in predicting economic levels. 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 overestimate.

I think it no exaggeration to say that the most important single economic and financial development of recent times has been the entry of the world into a new era of vigorous international 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 more than a dozen years ago, and, save for one exceptional year, have continued since. This constitutes a problem we dare not overlook and cannot ignore.

Increasingly we are all coming 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, in the right places, at the right times, and at the right prices.

But we also need a quality for which we have not always 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.

Now I should like to give you my views on where the Federal Reserve fits into the picture I have been trying to sketch, even though I don't think I can add anything new to what I have said on other occasions.

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 at home and its strength in international markets, and promote sustainable growth in the American economy. By so doing, the Federal Reserve can make an important contribution to improving the living standards of our people as a whole--though it cannot alone achieve that result 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, nonpartisan, impartial, informed, and in the interest of the country as a whole.

Accordingly, when Congress entrusted the power of money management to the Federal Reserve System during President Wilson's administration a half century ago, great care was taken 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.

Thus, we have in the Federal Reserve System something different from the Bank of England or European central banks, where authority is highly centralized. Instead, we have under the Federal Reserve Act a regional system that is now made up of 12 great regional banks with 24 branches, and some 260 directors. In addition, for supervision and for coordination of policy, we have the Board of Governors in Washington, consisting of seven men appointed by the President with the advice and consent of the Senate.

Because I share the view of Benjamin Disraeli that "individuals may form communities, but it is institutions alone that can create a nation," I should like to expand a bit on the institutional aspect of the System.

I think of the Federal Reserve as having a "trusteeship," created by Congress in the exercise of its constitutional powers, for the money of this country and of its people. That is a trusteeship that we take very seriously indeed, recognizing as we do that money and monetary policy cannot be considered in purely material or economic terms, for the simple reason that the ultimate purpose of both is to meet human needs.

Money performs a great many services for mankind, but none more important than in providing a degree of freedom that man could not attain if money did not exist. The bonds of serfdom that bound the mass of men for life to their native plot of soil and their native status in society were broken when payment in produce was supplanted by payment in cash.

Money gave men freedom of movement and leisure. It gave them the ability to change the nature and locality of their possessions and earnings at will. It gave them freedom to do as they please with the product of their labors--to eat it or drink it, to give it to a church or charity, to spend it on learning, to save its value against some unforeseen event, to use it to lift their living standards, or to put it aside to fortify their independence when they wished to assert it.

In short, money can be an instrument of freedom--if only we permit it to function in that role. But the power over money can also be an instrument of tyranny--witness the coin clipping by kings, a form of tyranny known at first hand by many of those who settled early in America. That is one of the reasons why there has been so much concern over monetary policy and monetary actions throughout our history.

When the First Bank of the United States was established under government charter, great effort was put into preventing the government, or political authority, from having any say over the bank and thus having a chance to indulge in coin clipping.

Gradually, as time went on, apprehension arose about too much private control over money. When the Second Bank of the United States was formed, there was some recognition that the public interest should be represented in the bank's set-up. So, the Congress made provision for public representation when it granted that bank's charter.

But to Andrew Jackson, and many others as well, it seemed that the public representation permitted was not enough. It was not that Jackson opposed the idea of any central bank, for he said in his veto message that such an institution "is in many respects convenient for the government and useful to the people." What he objected to was that this particular bank, as it was set up, provided private interests with what was, in the words of his veto message, "a monopoly--an exclusive privilege of banking. . . granted at the expense of the public." In consequence, Jackson destroyed the bank.

The enactment of the Federal Reserve Act, as part of Woodrow Wilson's "New Freedom," marked the beginning of what we might call modern times with respect to the role of government in monetary affairs. Jackson's complaint had been answered: there would not be private domination of money--nor political domination either.

Thus the Federal Reserve System was established as a nonprofit, public service institution that serves as I have said in a trustee's relationship with the people, which I think is something our people understand, partly out of their experience with the occasional necessity of having to ask someone else to look after their funds or property or members of their family. If the people don't want us in that relationship--well, the Federal Reserve System is a part of a democracy and they can change it. But that is the relationship we hold, and it can be dissolved only by due process of law.

In the discharge of its trusteeship, the System is concerned primarily with making money as useful as it can be as a mechanism for helping men freely to make their own decisions and choices in the marketplaces that serve as the cornerstone of our competitive, private enterprise economy. Making money useful in that sense necessarily requires maintaining confidence in the dollar itself as well as in the integrity and efficiency of the banking system.

Because we are the custodians of the greater part of the reserves the commercial banks are required to maintain, and because we can alter the volume of both total and required reserves, we can exert considerable influence over the readiness with which the banks will extend credit. The soundness of bank credit, as well as the efficient functioning of our market system, depends to a large extent on the Federal Reserve's decisions with respect to what it should do about the reserve position of the banking system from time to time.

For the most part, these decisions involve Federal Reserve purchase or sale of government securities. If we buy, we add to bank reserves, in effect substituting Federal Reserve credit for private credit that had been extended to the government, and freeing private funds for other purposes, thereby making credit easier to obtain. If we sell, the opposite effect is produced.

This arrangement has worked because our credit is good. If we continually made a practice of extending credit to the government solely to provide the Treasury with a cheap source of funds, we would ultimately neglect our responsibility for maintaining the value of the dollar and confidence in the banking system. And surely, in the end, the credit we extended would become worthless, even to the Treasury.

It was to guard against this result that the Congress endowed the Federal Reserve System with a considerable degree of independence. Independence of the System, to me, means simply that our decisions regarding extension of Federal Reserve credit must be made in the light of their long-range impact on the value of the dollar and the soundness of the credit structure on which our market system depends, and not out of solicitude for the momentary financing needs of the government. Independence does not mean that the Federal Reserve can establish goals in conflict with those of the President or the Congress. We should, and do, use our limited powers to produce a monetary climate in which the economy can flourish, adding its strength to the attainment of whatever goals Americans may seek. The Federal Reserve cannot overcome all the maladjustments that keep some Americans from sharing in the general prosperity any more than we can guarantee perpetual continuance of that prosperity. The Federal Reserve cannot make the policy decisions that determine ultimately whether this country's international transactions will come again into balance or its gold will flow abroad. What we can do, and all we can do, is to make credit decisions as soundly as our ability permits, so that transactions in international markets may proceed with a minimum of interference from speculative forays against the dollar, and so that domestic markets, in performing their task of bringing together those who seek goods and services and those who can supply them, may have the benefit of a reasonably stable price level. If this kind of credit climate is to be maintained, the decisions on which it depends should be made by an institution devoted solely to that end and responsible for its achievement. This is my conception of what Congress did in setting up the Federal Reserve System. This independence of judgment strengthens the formulation of the government's over-all economic policy, and the achievement of our national economic goals, as well as strengthening the credit structure on which the government must rely to accomplish its objectives.

Now let me note briefly what the Federal Reserve has been doing in recent times to keep credit conditions attuned to the needs of a nation confronted with both domestic and international problems.

On the domestic front, to help bring about 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 pull of international differentials in interest rates.

It is not my purpose either to apologize for or 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 fully in helping our country to deal with problems of diverse character. But I would not want to deceive you, or myself, by claiming victories that have not yet been won in a struggle that, by its nature, can never cease.

We do not claim the System is perfect or infallible. Being a human institution, it is neither. It has made mistakes, and undoubtedly it will make more of them, for the mind of man has not yet managed to devise any means of excluding error. In its half-century of existence, encompassing the ordeal of two world-embracing wars and between them the anguish of boom, crash, and depression, the System has experienced failures as well as successes. But it has also learned from experience, and I believe we can find considerable satisfaction in the extent to which the System over the years has accomplished the objectives set for it by Congress.

In any event, I can assure you that the Federal Reserve System today is wholly dedicated to contributing--to the maximum extent that monetary policy can contribute--to the achievement of maximum sustained employment, stable values, and a rising standard of living for all Americans.

In the last analysis, whether an institution renders good or bad public service will always depend more upon the character of the human beings engaged in its operations than upon its organizational form and structure. The solution of difficult and complex problems depends upon the ability of conscientious men to reconcile differences of opinion and come to a meeting of the minds on what best serves the public's good rather than upon the forms of institutional organization.

In his first inaugural address as President, Woodrow Wilson, in whose administration the Federal Reserve Act was passed, gave us some counsel about dealing with our economic system that I believe applies as well to the Federal Reserve itself. These are his words, as they are inscribed in part below his plaque in the Federal Reserve Building in Washington:

"We shall deal with our economic system as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon; and step by step we shall make it what it should be, in the spirit of those who question their own wisdom and seek counsel and knowledge, not shallow self-satisfaction or the excitement of excursions whither they cannot tell."