Cooperation of Monetary Policy in a Growing Economy

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Today I would like to make a few remarks on the place of monetary policy in the kind of world we live in — a world characterized mainly by rapid change, either evolutionary or revolutionary, both in our own country and in virtually all other nations. Now, unfortunately, there seems to have grown up around the concept of monetary policy an aura of ultra-conservatism, which suggests in the minds of some people that monetary policy is essentially negative, and hence obstructive of the more progressive elements in our society. To my mind this view is wholly misguided. In fact, monetary policy has contributed strongly to economic progress in recent years, and those who have been given the responsibility of shaping monetary policy in this country are genuinely interested in seeing to it that it should continue to be a factor in building a dynamic, viable, and growing domestic and world economy.

Doubtless a principal reason for this unfortunate public image of monetary policy is the degree of emphasis it has necessarily placed on fighting inflationary tendencies. There are critics who accuse the Federal Reserve System, for example, of being so obsessed with inflation that it has neglected equally important objectives in a one-sided effort to achieve price stability at all costs. My reply is that our greatest interest lies in achieving economic growth over a period of years at a sustainable rate, and that our close interest in price stability reflects mainly our belief that any appreciable degree of inflation is very likely to cause speculative distortions and to render unsustainable almost any rate of growth.

I do not mean to imply by "sustainable" that we can expect a completely smooth and steady growth, for some moderate fluctuations are not only probable in a free economy where millions of individual decisions are being made at all times, and where expectations are bound to range widely between optimism and pessimism, but such moderate fluctuations may even be a necessary condition for maximum average growth. Occasional lean periods seem to be necessary to increase incentives to eliminate waste and achieve greater efficiency, and thus to spur productivity. We must be firmly opposed to those superficial appearances of rapid growth which are so unsound as to carry the seeds of severe declines entailing heavy social losses in the form of large unemployment and large unused capacity. It has been argued that a higher rate of growth can be achieved if prices are allowed to "creep" upward. But I think that without this "creep" we are much more likely to avoid excessive spurts and severe declines and thus to attain the best average growth—and it is *average* growth that will count in the long-term competition between the free world and the Communist bloc.

I know of no way of setting a percentage figure on the annual rate of growth we should expect to attain. But it is clearly desirable to set our sights high in the competitive world we live in, always with this major proviso as to "sustainability". To cite specific figures, I cannot feel complacent with unemployment still around the four million mark, with our index of industrial production slightly lower now than in the autumn of 1955, and with per capita real disposable personal income virtually static for the past three years. Even after allowance for the considerable growth in population, dollar figures have given an illusory impression of growth because of the rise in prices.

The social injustices wrought by inflation have been depicted so often and so ably, that I shall pass over this phase of the problem, pausing only to repeat what has been said many times but has not yet sunk into our mentality deeply enough, i.e., that the consumers, the most numerous group in our population, are the least ably represented in political and market arenas. I should like to stress rather the importance of price stability as a cornerstone of growth, both national and international. I have already mentioned the danger that inflationary distortions tend eventually to collapse and to be followed by excessively sharp and severe declines in business activity, as history has demonstrated on many occasions. But there is another aspect we should not lose sight of. Essentially, economic growth depends on the orderly flow of savings into productive investments. There is nothing so likely to interfere with an adequate flow of savings, or to drive savings into unproductive uses, as a public conviction that the dollar will be worth much less after a few years because of erosion of its purchasing power. I am sure that the

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huge aggregate demand for capital, arising mainly from the investment programs of the past few years, would have been covered much more easily out of current savings if there had been complete confidence in a stable dollar in the years to come.

Let us consider also the relation of inflation to our vast international obligations. In the kind of world in which we live, a major contribution by the United States to the further development of the less developed nations is vital. Whether this takes the form of public aid or the more desirable form of private investment (and in fact it must include a good measure of both), the successful transfer of resources to carry out this assistance requires above all a cost structure in this country adequately competitive with foreign costs. If the large gold outflow of 1958 brought any benefits to this country (over and above the obvious benefits to international liquidity), perhaps the greatest was to impress on American business at least —and one would hope on American labor also—the fact that foreign competition is growing apace, both abroad and in our own markets, and that we can no longer conduct our affairs, monetary or otherwise, on the comfortable assumption that the international balance of payments is something that foreigners must worry about, but not we Americans. Now that European industries have rebuilt their capacity to supply export markets readily, we must place more emphasis on restraining cost increases and keeping competitive if we are to avoid a loss of jobs to many American workers.

The very fact that as a nation we have learned to cope more successfully than in earlier years with the problems of recession has tended to eliminate the "shake-out" in prices and wages which used to characterize periods of low business activity. Because of this it has been suggested that perhaps we should do less to limit recessionary tendencies. I find myself unwilling to accept that suggestion, with its implication that we must sit by and accept heavy economic and social losses—but certainly the condition I have outlined does point to a much greater need than in decades past for vigilance against sizable average price increases during the upward phase of the business cycle.

I hope you will agree that these various considerations make price stability an extremely important objective in our economy. You would think the case was so clear that all segments in our economy would join forces enthusiastically to achieve it. Yet in fact there has been a deplorable tendency to leave most of the burden to monetary policy—a burden which it is by no means equipped to carry alone. Even many of those who approve highly of monetary policy as a means of "fighting inflation" are all too prone to neglect their own spheres of responsibility where the fight on inflation can and must be effectively waged.

It is little wonder, under these circumstances, that a good deal of the monetary authorities' time and effort has been absorbed by efforts to hold inflationary tendencies in check. For one thing, monetary measures can be taken promptly, and without regard for the clamor of pressure groups; also their effects are probably more general and impersonal than any other type of Governmental control. They can be applied with a minimum of interference with the free market principles on which most of our economy is based. Both law and central banking tradition support a determination on our part to do what we can to protect the dollar's value. Certainly we would very much like to be able to spend less of our time worrying about this objective and to be able to devote more time and effort to promoting more rapid economic growth. The greater the cooperative effort by other elements in our economy to accomplish price stability, the less would be the need for restrictive credit policies.

The current situation is a good example of the kind of dilemma which credit policy is called upon to face. Although recovery is proceeding at a gratifying pace, the existence of very considerable unemployment and excess plant capacity in a good many industries would suggest that our policies should be encouraging further growth in production. On the other hand, while the general price level has shown considerable stability for a number of months, and the near-term outlook is fairly good, the seeds of renewed upward pressures are clearly visible and cannot be ignored. These include the increased liquidity effected in the economy in the past year, the continuing threat of further upward cost-price adjustments, the difficulty of bringing the budget back into balance, and the prevalence of "inflation" psychology as exemplified in the level of stock prices, all of which have led to apprehensions abroad as to what the future may hold for the value of the dollar. Taking all these considerations into account, our problem has been to keep a sufficiently close rein on bank reserves to discourage expectations or fears of inflationary developments in credit and the money supply, and yet to avoid interference with orderly recovery and a resumption of growth.

I believe one of the most effective ways to focus attention on this problem would be to amend the Employment Act of 1946 to provide specifically that preservation of stable value for the dollar is a major economic objective of all branches of the Government. This specific responsibility could not fail, I believe, to focus attention on the

need for better coordination of Federal spending and tax policies, debt management, and credit activities of various other Government agencies. It could provide them a clearer common link with the Federal Reserve System, and with our own credit policies.

Despite the very considerable help which our activities have had from budget surpluses in some recent years, the Federal fiscal position all too frequently has complicated the problem of conducting an effective credit policy. A bias in favor of deficits seems to be inherent in our methods of budget formation, in the inability of the Executive branch to eliminate individual expenditure items from aggregate spending bills, and the lack of any very close tie between the voting of expenditures with the voting of revenues provide the necessary funds. Thus, there is an understandable leaning on the part of the monetary authorities toward economy and restraint in Federal spending.

I should emphasize, however, that it is not for the monetary authorities to presume to decide how the nation should divide the use of its resources between private and public activities. That decision must be made by the people as a whole, both individually, and collectively through their elected representatives. However, it is, I think, quite appropriate for the monetary authorities to urge that, except in unusual circumstances such as a period of recession, whatever public expenditures are decided upon should be covered by taxes or other revenues, and that when boom conditions develop revenues should exceed expenditures. The current effort to produce a balanced budget in fiscal 1960 is a contribution of the greatest importance, not only toward fiscal responsibility, but also to monetary stability.

But it would be far from correct to say that the Federal Reserve System is opposed to useful and necessary public expenditures in themselves, whether for defense, foreign aid, or for such domestic programs as urban and highway improvements, school and housing development, etc. The argument may certainly be made that the nation needs more of such useful public expenditures. The key question is, however: "If the nation wants more of these items, is it willing to give up something in order to pay for them?" In other words, is it willing to shift more of the national resources from private to public use through a heavier tax program? With personal consumption accounting for the great bulk of private expenditures, such a shift would in all probability require a reduction in consumption of privately purchased goods and services through appropriate forms of taxation (unless, of course, the economy as a whole is growing fast enough to permit both public and private spending to expand). The reluctance of the American people to face this choice objectively, and the reluctance of many of our country's leaders to place the choice squarely before them, is one of the most disappointing features of our present economy. We might do well to look at the performance of various European countries, most recently France, where the people have been asked to face similar problems frankly and to make whatever sacrifices are called for in the public interest.

Monetary policy needs allies in the private sector of the economy just as much as it needs allies in the Government. I hope that management and labor are growing increasingly aware of their very real stake in price stability. The practice of restraint in pricing and wage settlements can be of inestimable value in furthering the national interest. As has been said so often in recent years, the granting of wage increases in excess of average productivity gains for the economy as a whole can only lead to the kind of inflationary pressures we are all seeking to avoid. Certainly the rate of improvement in national productivity should be considered an upper limit for the pace of wage increases. The granting of wage rises within this limit would mean that more of the productivity gains could be shared by the consumer, and still permit an adequate return on invested capital, both of which, it can be argued, have a legitimate claim to a portion of the gains. And the holding of wage increases within this limit would check the dilution of the purchasing power of wage earners and retired workers caused by rising costs and prices. While further study is perhaps needed before any figure can be relied upon as this upper limit for annual wage increases (including fringe benefits), it seems much more likely on the basis of past experience that it will turn out to be in the neighborhood of 2 per cent or 3 per cent on average than in the range of some of the major increases sought and achieved in the 1955-57 period. It is, in any case, gratifying that some of the major wage settlements in 1958 seemed to embody less inflationary fuel than those in earlier years. Restraint in wage settlements of course implies a responsibility for corresponding restraint in the price policies of industry.

At this point a word about interest rates may be in order. There is a popular tendency, even among some financial observers, to point to the Federal Reserve System as the arbiter of interest rate levels. Actually the System is operating on the periphery of our vast economic enterprise, exerting a marginal influence, it is true, but one which shrinks into relative insignificance in comparison with the over-all effect of aggregate capital and credit demands and the aggregate flow of savings—or with expecta-

tions of movements therein. This is especially true in the case of long-term rates, since the Fed is not ordinarily a direct participant in long-term securities markets and since the banks' activities in this field are more limited than in the short-term area. But even in the short-term area, the Fed is by no means the only influence, although admittedly it is an important one. Interest rates, in any case, are just symptoms of what is happening to affect the demand for and supply of funds in the various parts of the credit markets.

Above all, I should stress the fact that, while the Fed can modify the natural swings in rates, there are limits beyond which such action can only mean undue expansion of the money supply, if the effort is to prevent a rate rise; or undue credit restriction, if the effort is to prevent a drop in rates. In a free enterprise economy, interest rates are the simplest and most impersonal means of allocating savings among various demands for funds. And in order to have freely responsive rates, we are bound to have fluctuating bond prices, including Government bond prices. All of us would like to damp down the price movements which reflect excessive bond speculation, such as we experienced last summer; but there will always remain a certain range of movement reflecting basic business changes and the public's expectations of such changes. And no apparatus of controls can obscure these basic forces without impeding the adjustment mechanisms that a market economy must have.

Incidentally, the Treasury has certainly made a contribution to sound monetary conditions by demonstrating clearly its willingness to pay going interest rates on its new securities offerings.

I have been speaking purposely in very general terms. We all know that it is sometimes a complex and difficult problem to move from sound general principles to effective day-to-day practices. I would be the first to admit that there is a vast amount we don't know about the detailed techniques of monetary policy—about adequate measures of liquidity, in and out of the banking system, about the effect of varying liquidity upon our own monetary measures, about the extent to which nonbank credit agencies, private and Government, may lie beyond the effective range of our activities. These and many other problems deserve the kind of long-range disinterested study which the Radcliffe Committee is devoting to them in Britain, and which the C.E.D. is endeavoring to initiate in this country.

In the meantime, I fervently hope that as a nation we can achieve more general and widespread understanding of the role which monetary policy is trying to play—of the close interrelationship of our monetary activities and the other economic policies of Government, as well as the policies of management and labor. Above all, what we need is a clearer appreciation of the fact that we are all engaged in a common enterprise, seeking essentially the same inspiring goal of maximum sustainable economic growth and a stable dollar. It is an enterprise in which each of us can be really successful only if we obtain the wholehearted cooperation of the others. The ground I have been over is pretty familiar—but it seemed to me that sound principles are always worth restating. I trust that in the future, as in the past, the banking community can be counted on to do its part to further this common enterprise and to use its position of vantage to create better understanding of these matters in all segments of our growing economy.