For Release on Delivery
(Approximately 12:45 p.m.,
Eastern Standard Time,
February 8, 1956.)

PARTNERS IN PRUDENCE

Address of C. Canby Balderston,

Vice Chairman, Board of Governors of the Federal Reserve System,

Before the New York Clearing House Luncheon,
37th Mid-Winter Trust Conference,
American Bankers Association,

The Waldorf-Astoria,
New York, New York,

on Wednesday, February 8, 1956.

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Prosperity has a price. It consists of a willingness on the part of all who make business decisions to forego excessive speculation. Otherwise, the recovery process as it gains momentum tends to sow the seeds of its own deterioration.

The business crises of the past indicate that the continuance of a high prosperity, such as we are now enjoying, turns on a combination of sound monetary and fiscal policies with prudent decisions by business executives and individuals, both sellers and consumers. Monetary policy alone cannot preserve economic equilibrium. It needs support from at least two partners: fiscal policy and business decisions.

It has been observed sagely by Dr. Riefler of the Board's staff that the quality of a business situation is no better than the quality of its executive decisions. When the latter are determined on the basis of speculative fervor and unwarranted optimism, they lack the objectivity so necessary for success. If such decisions result in overextension of plant, they tie up capital needlessly; if they result in the overaccumulation of inventories, they set the stage for inventory losses in the event of spoilage, obsolescence, or price decline. When business has reached a level as high as at present, care is needed to avoid the wastes that follow from ill-considered decisions. Of all periods in the business cycle, the prosperity period needs most the kind of philosophy that guides trust officers.

What is needed is neither the excessive conservatism that inhibits adventure and growth nor actions based upon pure speculation. In recovery periods, the economy needs a nice balance between protection and risk, between caution and daring, between liquidity and the expansion that borrowing makes possible. At such times it is important for business to continue at as high a level of production and employment as is compatible with stable prices. This means operating near capacity but not beyond it so that the general price level will not be disturbed unduly by aggregate demand increasing beyond capacity, thus raising prices. The prudence that I urge as an appropriate philosophy for business in times of prosperity is essential if prosperity is to be enjoyed and not undermined. For the trust companies you represent, however, it is a philosophy that applies to all phases of the business cycle because those who entrust their savings to your care expect to obtain the prudent guardianship of funds continuously from an institution that has perpetual life.

The Federal Reserve System is also a trustee. The Congress has delegated to it the responsibility over money. The Federal Reserve's task is to provide the amount of credit and currency needed at a given time without inducing either inflation or deflation. The scope of its responsibility embraces the supply, availability and cost of credit.

The philosophy of trusteeship which permeates its activities means that it has obligations to all citizens. These obligations cannot be defined in narrow terms. They embrace the fostering of sustainable economic growth with its products of high employment and low unemployment as well as the maintenance of a stable purchasing power for the dollar. Dealing as it does with money and with the quality of our monetary unit, the System has a sacred trust to be carried out regardless of the popularity or unpopularity of its policies and regardless of pressures from any direction.

The main purpose of the central banking mechanism, the Federal Reserve System, is to help provide enough credit and currency to foster a high utilization of the nation's physical resources, technical skills, and manpower without inflation. Provision of the right amount of credit and currency at a given time for given conditions is at the very heart of the central banking problem. It is the goal of Federal Reserve policy. Thus the supreme task of the Federal Reserve System is to help foster economic growth without inflation. For the wage earner, this means job opportunities that will enable him to provide for his family. For the saver, it means a dollar of stable buying power so that what has been put by as a result of hard labor and self-denial will not be lost. That is a meaning that will be clear to pensioners, widows, teachers and all others who are dependent on fixed incomes.

The mounting importance of pension, profit-sharing and welfare funds means that labor has an increasing stake in protecting the purchasing power of workers annuities and other benefits. Since these arrangements are contractual, a stable dollar is vital to protect pensioners and other beneficiaries. The millions who are covered by social insurance likewise are concerned as to how much their payments will buy when they are old enough to receive them. In short, a new dimension has been added to the nation's saving program that causes wage earners, and especially former wage earners, to suffer loss if the general price level rises.

The impact of the general supply of money upon the economy and upon nearly all citizens is so great as to make it a matter of public interest.

Therefore, supervision and control by the government is required. The apportionment of credit among individual borrowers, however, is not a matter for government, but for private lenders. To determine, on the basis of intimate knowledge, which businessmen and which firms are good risks is one of the important contributions of an independnent, private, commercial banking system. It is the responsibility of the central bank to exert an influence over the total amount of money, but the determination of the particular customers who are to get loans is and should be left to the commercial banks. The role of the Federal Reserve is potent and indispensable, but it operates indirectly through relatively free and uncontrolled markets so that there will be a minimum of interference with the essential freedoms of our enterprise system.

The quality of the decisions made by the monetary authorities turns, in part at least, upon the validity and adequacy of the information at their disposal. We are fortunate indeed to have made great strides in recent years in improving our economic knowledge, and in reducing this knowledge to measurements that permit more accurate economic judgments. There are, however, many gaps in this knowledge, many uncharted areas of economic behavior that remain for exploration. High among these I would rank the area with which you are most directly concerned: personal trusts. As your President, Mr. R. P. Chapman, recently indicated, our knowledge of such elementary facts as the total economic wealth administered through bank trust departments is quite scanty.

We at the Federal Reserve are working on this problem with the cooperation of the officials of your organization. We hope that over the years there can be developed accurate, comprehensive, and current measures of the flow of funds through this important channel for savings. Facts so developed should contribute substantially to the ability of monetary authorities to understand the basic forces of the economy and to improve the quality of their decisions.

While the System feels the need for fuller information concerning the aggregates of wealth and savings which you administer, as well as trends in the changing composition of fiduciary investments, it recognizes the obstacles to obtaining wholly accurate data of this kind. These obstacles stem from trust department bookkeeping practices--notably lack of uniformity in the way assets are carried and from the varied nature of the responsibilities and limitations imposed by trust instruments. Therefore, if any progress is to be made to increase the supply of factual information, it must involve careful planning and consultation with representative trust officers. Whatever fact finding is eventually developed should yield results of accuracy and significance. Otherwise it would lead to misinterpretation and inaccurate conclusions.

After this side comment concerning the pros and cons of some cautious joint exploration of some additional facts relating to trust activities, I return to our principal topic, "partners in prudence".

Monetary policy cannot alone be an adequate restraint upon inflationary influences any more than it can alone cure depression. It is potent only if it has allies and partners.

In one sense, these partners are as numerous as the individuals who buy and sell, borrow and lend, whether acting for themselves or as corporate executives. It is more useful, however, to identify the major partners by their areas. These include:

--Fiscal policy, including budgeting and taxing at all levels of government. Fortunately, the Federal budget is now in the black, if only by a shade, which decreases the load upon monetary policy.

--The management of the Federal debt--a debt large in the absolute though it has been growing less relative to the national income.

--The prudence of business executives with respect to borrowing, to expanding plant and inventories, and to price setting.

--The quality of the decisions by union leadership with regard to wage advances, especially in situations that set new wage patterns that will be copied widely.

--Investor discrimination between prudent investment and speculation. There is no need to dwell on the danger of "chasing the fast buck" and of overly discounting future growth and earnings. An old saying covers that subject succinctly: "It is all right to discount the future, but not the hereafter."

These principal partners in the continuing struggle to achieve a high but sustainable prosperity need both skill and a sense of public obligation. Their problem is to keep the economy running at high speed without straining its capacity. The economy moves forward on a continuous stream of transactions, large and small. It is like the movement of traffic on a heavily crowded highway. High speed is possible only if the drivers combine skill with prudence and observe certain rules thrown up by experience. Just one irresponsible driver, ignoring these time-tested rules, can wreck himself and others. Moreover, the traffic will move successfully at high speed only if there is some coordination between the volume of cars and the capacity of the road. Bottlenecks create traffic jams that not only halt progress temporarily but take time to unravel.

So it is in the flow of business. In its tradition are plenty of examples to indicate that forward movements, even those that appear to have a solid basis, may be spoiled by imprudence.

The rules of the economic road are well understood even if they are sometimes ignored. There must be a proper balance between protection and risk, between equity and debt. The quality of debt must not be impaired by equity that is overly thin. Values must not be inflated by excessive speculation. Prices of products sold in large volume must not be pushed upward by pressures upon capacity. On the other hand, willingness to adventure must not be inhibited by fears stemming from the magnification of temporary and perhaps insignificant weaknesses in the economy.

All of this means that the principal partners, who are after all the ones most responsible, must pull together as a team. The improvidence and indiscretion of any one can spoil a prosperity that is ours to enjoy if prudence in our public and private decisions is maintained. The world's leading economy is strong and rich in promise. Our common responsibility is to protect its health. An ounce of forethought is worth many pounds of regret.