For Release on Delivery
(Approximately 12:30 p.m, EST,
Monday, April 20, 1959.)

THE LATE RECESSION--ITS LOSSES AND LESSONS

Address by C. Canby Balderston,

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

Before the Philadelphia Bond Club,

Philadelphia, Pennsylvania,

April 20, 1959.

THE LATE RECESSION--ITS LOSSES AND LESSONS

The cyclical contraction that ended in April of last year was one of the shortest on record. It has been followed by a recovery of classic pattern that has now pushed most of the business indicators through their previous ceilings. Personal income in constant dollars has gone 2-1/2 per cent beyond its prerecession high. Real gross national product and industrial production have achieved new records. The trough from which we emerged followed a giant wave of consumer buying capped by plant expansion. Over-capacity and excessive inventories led inexorably to painful correction in the form of recession, with its worries, losses and tribulations.

It is now time to take stock of the residual difficulties that still face us. Three major problems may be summarized in three words: unemployment, prices, and debt.

Unemployment is down from its recession levels, but it continues to plague the mining regions and areas dependent upon heavy industry. The list of cities with one out of eight workers jobless contains the long-suffering coal towns of Scranton, Wilkes-Barre and Huntington. These have been joined by Buffalo, Erie and even Detroit, which has been the epitome of American initiative and mass production know-how. The rate of unemployment 19 months after the last cycle peak is only slightly above comparable experience in 1948-50, but is higher than the 1953-55 experience by about one per cent.

Such a comparison may comfort statisticians but not the families afflicted. Even though further expansion will tend to put the idle to work as overtime fails to meet the demand, an unemployment level of over

4 million beings should lead us to question whether job opportunities would not be greater if some prices were lower.

As expansion continues, the rising investment demand stemming from industrial research and management initiative will require an increased flow of savings. If we are to remain competitive at home and abroad, we shall need not only capital for implementing technological advance, but competitive prices as well. Competition is, of course, a relative matter. How do our products compare with those made in other countries as to quality, price and promptness of delivery? While we have improved, others may have been improving even more rapidly. Early this year our exports were down one-fifth from early 1957. This decline may be explained, in part, by cyclical developments abroad which reduced foreign demands for our raw materials and finished goods. At the same time, there is clear evidence that our cherished advantage in some types of machinery, as well as in autos and certain other mass-produced items has been diminishing. This is a situation that will not be cured by ignoring it, or by the mere passage of time, or by passing laws. The sole solution lies in keeping our costs (including labor costs) competitive so that American firms may produce what enough people want, at prices they are willing and able to pay.

Prices were buoyant during the recent decline and subsequent recovery. In the recession, the industrial-price average fell less than one per cent, even though prices of materials slipped considerably. This was similar to the 1953-54 experience. Early last year, however, prices of farm products and foods went up sharply. As a result the total wholesale price index rose one per cent during the period of business contraction.

Since the turnaround in business activity in May 1958, the average of industrial prices has risen 2 per cent and is now about 1-1/2 per cent above the previous all-time high. Though there has been unused capacity of human resources and manufacturing plants, industrial prices have risen sooner and faster than in the two previous recoveries when prices did not advance significantly until after output was well above its previous peak. One may ponder the question: have we paid the fee for an adjustment we didn't get?

In this Devil's Brew of trouble, containing unemployment and advancing prices, there is also the ingredient of debt. I refer not alone to consumer and to business debt, but to that of local, State and Federal governments.

In 1958 the growth in consumer instalment debt slackened, but total consumer indebtedness, including residential mortgage credit, still grew by $10.7 billion --a large figure even if less than the $18.9 billion rise in 1955. Practically all of last year's rise was in mortgage debt on family houses which mounted $10.4 billion to a total of $118 billion. Fortunately, this rise in the debt of individuals was more than offset by an increase in their financial assets, and so 1958 was a year in which consumer saving continued at a high rate. Now, however, both consumer instalment and mortgage debt are rising sharply.

But the governmental debt situation is far different. It is not necessary to detail the plight of State and local governments in increasing their revenues. Their troubles are being widely publicized. The Federal government's spending in excess of its revenue, however, is especially serious because financing it has been complicated by the attitude of savers toward fixed-income securities in general, and government bonds in particular. Thus, balancing the Federal budget is more than a problem for the Budget Director; it is an evidence of the nation's determination to protect the integrity of the dollar as a store of value. As such, our budget behavior is watched by the financially sophisticated the world over.

Whereas the Federal government had a cash surplus of $2.1 billion in fiscal 1957 and a small deficit of $1.5 billion in fiscal 1958, it is incurring a whopping cash deficit of over $13 billion in the current fiscal year. Federal cash receipts in fiscal 1959 will be about the same as in fiscal 1958, but expenditures will be close to $12 billion larger than in fiscal 1958 and $15 billion larger than in fiscal 1957.

Consequently, the Treasury has been frequently in the market for funds because of fiscal decisions made in the past. The deficit that has to be financed currently is arising out of decisions made a year ago and earlier. For some time in the future we will have to live with the fiscal decisions now being made. We are all aware of the circumstances that have given rise to large national defense expenditures. At the same time, non-military Federal expenditures have also increased, partly as the result of farm price-support programs, partly as the result of governmental actions taken to offset recession, and partly as the result of such built-in stabilizers as unemployment compensation. Prospects are that although economic recovery will bring a big increase in receipts next year, expenditures will continue large. The attainment of a balance is precarious unless positive measures are adopted.

I turn now to certain Federal Reserve problems that are current. A basic function of the System is to supply banks with reserves that will provide the volume of credit that is in keeping with stable economic growth. The objective is to supply neither too much credit nor too little. Monetary policy made credit easy during the period of economic contraction in order to hasten the turn around. Credit continued easy throughout the early recovery period and the money supply expanded very rapidly from February to August. If the money supply be measured by currency and demand deposits, the annual rate of increase (seasonally adjusted) was about 8 per cent in that brief period. For those who prefer to include time deposits in their definition, the rate of expansion was even more rapid. With vigorous recovery of business in the second half of the year, the Federal Reserve System acted to moderate expansion in the money supply so that the increase for the entire year 1958 was about 4 per cent. Was this sharp counter-recession increase of the appropriate amount? Or did it exceed the needs for stable growth?

Another problem faced by the System is to help achieve and maintain a proper relation between the total of demands on the capital markets and the total flow of saving. If these capital needs cannot be met out of voluntary savings and if an increase in the money supply under such circumstances would be inflationary, a monetary policy geared to sustainable growth must be restrictive and some would-be borrowers must be disappointed.

Lessons of the Recession and Current Concerns

It is illuminating to ponder recent history in order to distill from it whatever lessons it may teach us. Take business capital expenditures.

In the year 1955 we enjoyed an extraordinarily high level of consumer expenditures for automobiles, for housing, and for many durable goods. Businessmen, encouraged by these strong demands, stepped up their capital expenditures, partly because they were projecting these demands into the future. The record level of outlays for fixed capital helped sustain economic activity in 1956 and much of 1957, even though consumer spending for durables and housing had receded sharply. Then businessmen in many industries decided their capacity was great enough to match foreseeable demand --sometimes even greater. They cut back their expansion programs. The consequent falling off of business capital expenditures in 1957 was clearly a major factor in the recession.

By the same token, the inventory policies that had seemed appropriate in the light of peak business activity were found by the fall of 1957 to be out of keeping with existing needs. And so there began a period of rapid inventory liquidation. Query: Is the present rate of inventory accumulation sustainable?

Many of the currently prevailing prices and wage rates also represent decisions made some time ago. We are not sure of the extent to which the inflexibility of industrial prices during the recession represented lags in the price and wage determining process. But price rises during a recession are certainly no help in fostering recovery.

Diluting the purchasing power of the dollar does not provide permanent employment opportunities. Persistent depreciation in the value of the dollar does injure those who must live on fixed incomes. But the protection of the purchasing power of the dollar goes beyond the important consideration of equity for such individuals. For one thing, inflation diverts business energy into speculation and away from the increasing of output and of productivity. We know that hyperinflation is disruptive to the productive process; even small doses of inflation are inconsistent with well-maintained productive activity.

Per capita growth is largely dependent upon technological advances bolstered by sufficient capital to take advantage of them. It is a mistake to equate economic growth with governmental spending. We must ask ourselves: What kinds of growth are most beneficial? What kinds of governmental spending are conducive to stable growth and what kinds are detrimental?

I should observe, in passing, that GNP is too limited a measure of a country's progress and of its ability to satisfy human wants to serve as the sole basis for comparing our country with other countries that operate under entirely different rules. The dollar value of GNP may rise while living standards fall or while job-creating activity declines. Furthermore, material goals are only one aspect of our way of life. In the economic sphere, however, what is it we desire to be able to produce in greater quantity? Is it more missiles, or more perfume? More plant capacity, or more schools and roads, or more farm crops? More producer goods, or more consumer goods and services? In our economy, of course, the majority of these decisions are made in the market place. The role of government, however, has been progressively widened.

Government spending will not enhance the savings required to provide the tools and other capital equipment needed. Spending dictated by pressure groups will scarcely achieve the changes needed for real and sustainable growth--in fact, it may impede such changes. Economic growth has been associated with the shifting of resources, human and material, to new industries and from less productive industries and occupations to those of higher productivity. A major example of changes in patterns of resource utilization is the continued shift of farm workers and land to urban uses. The shifting of resources nonetheless may exact temporarily a price in unemployment. In New England it is only in recent years that the decline of the textile industry has been offset by the emergence of the electronic and other new industries.

Healthy growth of the economy can be attained only by a close gearing of bank credit expansion with that of the economy generally. Such growth requires that the central banking system provide enough but not too much money to achieve and maintain balanced growth without inflation. Recent historical research of the National Bureau of Economic Research shows that, while growth rates have fluctuated considerably in the short run, the growth process, if measured by decades, has been remarkably durable. Except for the decade containing the Great Depression we have had appreciable growth during every decade for the last 70 years. A highly significant point brought out by this research is that growth was strong during the period of falling prices which came in the last third of the 19th century; and that growth was rapid during the decade of the 1920's when prices were fairly stable. This evidence suggests that price stability and rapid growth are quite compatible. The essential point is that per capita growth depends to a considerable extent on greater productivity. Productivity, in turn, depends on the existence of a flexible economic system, one ready to use advanced technology.

The decision-making process needs guideposts. It needs to be governed by some general view as to our ultimate goals; what we think worth while and are willing to strive for. National economic objectives permeate the decision-making process. As long as our citizens deal with general objectives, there is very little dispute. Everyone wants the country's standard of living to continue to rise. Prosperity and adequate job opportunities are goals that all agree upon, and so sustainable growth without inflation is high among our accepted objectives. Political and economic freedom are American hallmarks.

The freedom to make private economic decisions is not only consistent with our system of economic and governmental organization; it is one of the basic human values that we prize. But freedom can be preserved only so long as it is accompanied by wisdom and restraint. Moreover, our freedom does not include freedom from the consequences of natural economic law. Each time we elect to spend, we must figure out how the bill will be paid.

In homespun language, "There is no such thing as a free lunch." Government cannot give to some citizens what it does not take from others. A nation cannot spend more than it earns through production. The goods we enjoy have to be produced by someone's sweat and by someone's saving. Intemperate and unwise decisions could squander our resources, magnificent as they are. But if our decisions are prudent and balanced, and if we assess correctly our nation's capacity to grow and prosper, we should enjoy the great bounty that it can produce. It would be tragic if inept financial husbandry were to injure a future that appears to be so rich in promise and in hope.