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before the

Joint Committee on the Economic Report

Considering The President's Economic Report

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For nearly a decade and a half, our economy has been dominated by war, the economic consequences of war and preparedness against war.

We are now undergoing a transition towards greater reliance upon the private sectors of our economy and less upon defense-stimulated public activity.

Since prewar years, the economy has enormously expanded. For an unusually long time, it has operated at high, at times very high, levels of employment. We have become accustomed to recurrent shortgages, to waves of inflationary pressures, and to rapidly expanding output. To some people, any change from these familiar conditions seems ominous. Surely, it would be the height of folly to ride the witch's broomstick of inflation to the inevitable crash.

Anxiety can be overdone. Unless exposed to the broad daylight of facts it could lead to severe declines in buying and hence in production and employment. There's a realistic medium somewhere between being a Pollyanna and a Cassandra. Realistically, after so long a period of upswing--much of it under forced draft--we need to expect a period of testing of the economy's basic strength and resiliency.

The only certain way of dealing with the problems confronting us is to face up to them and work together to appraise and to meet them. The salient facts about the economy's current position and its problems are set forth in the Economic Report of the President, which is before you. I should like to discuss some of them from the standpoint of the Federal Reserve.

## Recent Production and Employment Developments

Since mid-summer 1953, the Reserve Board's index of industrial production has declined almost as much as during the mild recession of 1948-49, when it dropped about 10 per cent. Since late summer, unemployment has doubled. But it should be borne in mind that the decline in production has taken place from a record high level, and unemployment has increased from a record postwar low level.

Currently, where excessive stocks exist, businessmen are undertaking to bring them into line with sales. Competition has been intensified, not among buyers as during the war and much of the postwar period, but among sellers. Efforts are being made to cut costs, please customers, improve products, meet market needs, and keep financial commitments prudent. The consumer is no longer a forgotten man, and that is as it should be in a healthy economy.

Even after the downward adjustment that has taken place, the current level of activity today is high. Output at factories and mines, while less than in early 1953, is greater than in early 1952. Unemployment is only moderately above January of the last two years and consumers, whose purchases take nearly two-thirds of the nation's output, are buying as much as a year ago.

The slackening in economic activity since mid-1953 is the first decline in over-all output of goods and services since 1949. Gross national product declined from a seasonally adjusted annual rate of 371 billion dollars in the second quarter to an estimated 362 billion in the fourth quarter, when total product was about at the level of a year earlier. Reflecting these changes, mid-year employment and hours of work have been reduced and the labor market generally has eased. Unemployment has risen from its postwar low of 1.2 million to an estimated 2.4 million in January, reflecting in part seasonal influences.

This is the vital statistic we must watch vigilantly. Since the end and aim of our society is the welfare of human beings, we cannot and we need not tolerate the cruelty, the indignity of widespread loss of opportunity for gainful employment. Men may differ over what is or is not a tolerable level of unemployment. I do not subscribe to the harsh notion that some unemployment--how much is rarely stated--is a good thing. The man who wants to work and earn a livelihood cannot be expected to be tolerant about any statistical figure of unemployment if it includes him.

However, variation in employment from time to time is inevitable in a modern, progressive economy. It is an inescapable part of the process of progress. For every village smithy that flourished in the horse and buggy age there are scores of garages and service stations today. Progress ends some jobs but creates new ones in increasing numbers.

I do profoundly believe that no other system of government, no other economic order, could have liberated the forces, the energies, the inventiveness, which have brought forth in this nation an abundance, a rising standard of living for its people that is unrivalled in all the history of the world. The faults lie not in our economic system but rather with us. We have learned something about economic measures to minimize the evils of unemployment; for example, we have a nation-wide system of insurance to help tide over periods of downturn. We must seek constantly to alleviate the human suffering and to reduce the economic waste of unemployment. That is of the essence of progress under our institutions. It is a primary concern of this Committee.

Some Factors in the Current Downturn

A key factor in receding activity has been a turnabout of business spending for inventories. Last spring, when as a nation we were producing more than we were buying, inventories were being built up at an annual rate of 7 billion dollars. At year-end they were being reduced. The reduction in spending for inventories was as large as the decline in total output of goods and services. If the current readjustment period is primarily the result of an inventory overload, the speed and orderly nature of this adjustment is encouraging.

Following three years of steady buildup, a gradual reduction in defense spending since the middle of last year has also contributed to lessened activity. Such spending is still large and continues to account for about one-seventh of total national product.

Other types of activity have been well maintained. State and local outlays for current operations and for schools, roads, and other public works have continued to rise. Business expenditures for fixed capital have held close to record levels. Residential building has strengthened following some easing last spring and summer. Consumer spending for services has increased further and other consumer buying has been well maintained.

Some declines in imports of industrial materials have accompanied reductions in output, but exports were steady throughout 1953. Maintenance of foreign purchases of American products has reflected, on the one hand, high and generally rising demands abroad, and, on the other hand, the growing financial strength of other nations outside the Communist orbit.

The downward adjustment thus far has been orderly. There has been no perceptible weakening of the economy's financial fabric. Price changes have been selective, and largely offsetting. After earlier declines, average prices of farm products and industrial materials have been fairly steady for some months, with price supports a special factor in the stability of the farm sector.

Reduction in personal income taxes, effective January 1, and increased unemployment compensation benefits have largely offset declines in personal income. Corporate incomes after taxes have benefited by the expiration of the excess profits tax. Consumers and businessmen, while more cautious than earlier, continue to reflect confident attitudes regarding their financial positions and in their acquisition of tangible assets. The equity positions of the major sectors of the economy continue strong in comparison with other high level periods of history. From their mid-year highs, market interest rates have declined appreciably and credit has become more readily available.

Declines in economic activity and employment are rightly a matter of concern. In the light of history, however, it would be unrealistic to expect the economy to perform indefinitely without pause. All in all, the performance of the economy since mid-year is evidence of marked underlying strength and resiliency.

Role of Credit and Monetary Policy

Broadly speaking, there are always two dangers to be avoided in a growing economy: a too rapid upsurge of demand pressures, producing inflation; or a too rapid contraction of spending, producing deflation.

In the credit and monetary field, the Federal Reserve has tried tobe alert to the shifting of forces at work in the economy and to take appropriate action. A year ago, the System raised rediscount rates and followed a policy of restraint of excessive bank credit expansion in order to be on the safe side in guarding against inflationary pressures. At that time, speculative trends appeared to be developing in demands for credit, particularly for credit which might find its way into top-heavy business inventories.

As the inflationary threat abated in the late spring and summer, the Reserve System acted, beginning May 8 of last year, to provide assurance to financial markets and to business that legitimate needs for funds for stability and growth would be met, including those of business, consumers, and the Treasury. It was also clear by summer that the earlier excessive exuberance had disappeared. By easing credit, through reducing reserve requirements early last July, it was felt that inventory adjustments could proceed in an orderly manner. It was also felt that, if mortgage and other markets for longer term funds would become more settled, they would more effectively contribute their share to the maintenance of a high level of activity in housing, private capital investment, and State and local government projects.

In early autumn, and again near the end of the year, the Reserve System took further steps through open market operations to provide the reserves necessary to meet seasonal currency demands and deposit expansion. These steps, at a time of slackening private credit demands, contributed to a condition of active ease in credit availability, appropriate to a period of readjustment such as we have been experiencing.

Some Considerations, Looking Ahead

In looking beyond the next few months there are a number of fundamental considerations which need to be kept in mind in appraising economic developments and in shaping legislation designed to foster a continuing high level of employment and activity. These considerations, I think, merit attention:

In the transition to an economy dominated by private wants and competitive market forces, we need to reorient our thinking and to recognize that markets go down as well as up. In our competitive, private enterprise economy, we rely primarily upon the operation of market forces in adjusting to changing conditions of demand and supply. That does not mean a fatalistic acceptance of low levels of activity but rather a conviction that our vast resources and energies can thus be utilized more fully in raising the standard of living.

Long-run growth in the economy must stem increasingly from private demands. Consumers purchase directly the bulk of the nation's output. In the period ahead as Government requirements are reduced, private consumption should increase. Therefore, future growth of private demand depends largely on the willingness and ability of consumers steadily to expand their purchases. Business has to be constantly alert to potential shifts in consumer needs and buying psychology in order to anticipate and meet them by developing improved or new products and services at prices the consumer can and will pay.

Stocks of houses and of many durable goods have been greatly increased since the war. More than 8 million permanent non-farm dwelling units have been built; the number of passenger cars on the road has increased from 26 million to 44 million. Even so, there is still a great need for housing as the number of households and the population continue to grow. Similarly, while the number of cars on the road has greatly increased, the number still in use that are ten years or more old totals about 11 million. As to other durable goods, improvements have increased the rate of obsolescence of many old models and thus have added to replacement demand. Meanwhile, introduction of new types of durable goods should help to sustain a high volume of total output of consumer durables.

Plant and equipment expenditures of business in postwar years, despite their high levels, have not been markedly different in their relation to total national product from those in earlier years of high level activity. While expansion since Korea has been accelerated in various defense areas, it has been reduced in others. In the case of electric power, rapid expansion of demand has maintained strong pressure for investment in new facilities.

Increased levels of production costs resulting primarily from postwar inflation, together with the rapid development of technology, provide strong incentives for further large business capital expenditures. In many instances, these incentives are strengthened rather than weakened by more competitive markets. Industrial research is daily uncovering new opportunities for business investment.

We continue to have backlog needs for investment in commercial, office building, hotel, church, and hospital facilities, and the need for public works--schools, other public facilities, roads and highways--seems insatiable. The problem for the future is mainly how to translate these basic needs into effective market demand.

In the international economy, recovery in output and supplies and restoration of stable monetary conditions have gone far enough to enable the countries of Europe to participate aggressively in world markets. There has been growing belief in the possibility of linking together the market economies of free world countries into a single system with fewer barriers to trade and investment. If this country can maintain or expand its import volume and if further progress can be made towards financial stability abroad, a cumulative lifting of world trade and investment barriers appears to be quite feasible, thus opening the way for expansion of capital flows to, and trade with, underdeveloped and rapidly developing areas.

Private debt in this country has undergone swift growth during the postwar period--more rapid than would be likely in a period of price stability--but it is well to keep in mind that it was not at an unduly high level at the end of the war. National wealth, in real terms as well as in current prices, has increased more than debt over post-war years. This is in contrast with the 1920's when the substantial increase in private debt was barely matched by growth in wealth. At present, private financial positions--business and consumer--while much less liquid than at the end of World War II, are nevertheless relatively favorable in comparison with the prewar period.

I have touched on these various aspects of the economy because they are part of the background and foreground one must have in mind in connection with monetary and credit policy. The Economic Report before you summarizes what has been done in coordinating the field of debt management with that of monetary and credit policy--and I need not elaborate on it here.

I want to emphasize, however, the adaptability and flexibility of monetary and credit policy. It is and must be closely coordinated with debt management, but so far as credit and monetary policy is concerned, we are on our own in the Federal Reserve System. If we have erred, the responsibility is solely ours. The record demonstrates, I think, that we have sought to be alert to change, and if possible to anticipate it, and to adapt policy to it. In that, I think, lies another reason for the "cautious optimism" that I would say is my attitude towards the future of the economy. We will strive to make available that volume of reserves, which is difficult to measure with fine precision ahead of time, that will help to safeguard the economy from the "too much" that feeds inflation, or the "too little" that feeds deflation. In other words, the goal is a growing economy, and a rising standard of living. On that objective we can all agree.

Credit and monetary policy is potent but not omnipotent. It cannot, alone, keep us on an even keel of forward progress. Yet without it, the goal of stable progress would, I think, elude us entirely. It must be timely, flexible, adaptable, as I have said, and it must not only be properly coordinated with debt management but it must be consistent with our institutions, including our concept of the market place. It is fair to say, I believe, that we have made notable progress during the past year towards freer, self-reliant money markets that are the hallmark of democratic, private enterprise institutions.

The considerations which I have touched on do not, to be sure, dispose of all the problems that can be raised respecting the future. A modern, progressive economy, activated and coordinated through the incentive play of market prices, will be characterized by instabilities in particular markets and by changes in the rhythm of total activity. The central problem of public as well as private policies is to maintain a steady and sustainable pace of general expansion. That is the aim of credit and monetary policy.

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