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(Approximately 1:00 p.m., EST,
Monday, March 3, 1958.)

Summary of Remarks of C. Canby Balderston, Vice Chairman,
Board of Governors of the Federal Reserve System,
at the University of Pennsylvania Alumni Club Luncheon,
in Baltimore, Maryland, on Monday, March 3, 1958.

The basic economic question that has been facing our nation is how to provide for continuing and healthy growth without inflation. Obviously, the expansion of credit and currency should be adequate to sustain economic growth. It is equally obvious that excessive and unsound credit expansion can thwart progress. If the purchasing power of the dollar declines persistently, the incentive to save is undermined and business executives in their decision-making tend to substitute speculation for the goal of long-run efficiency. Instead of making decisions prudently in the light of well-founded expectations, businessmen are tempted to speculate on steadily rising costs and values, gambling upon being able to pass on, in price increases, the additional costs of forward commitments. Out of such imprudence come the unsustainable booms and subsequent crises that have punctuated our industrial history.

It is my conviction that the two objectives of monetary and fiscal policy--economic growth and monetary stability--are inseparably linked. In the long run, they stand or fall together. The orderly sustainable growth of our economy, and the provision of the savings necessary to it, are most unlikely unless the purchasing power of the dollar is kept stable.

But has the growth of our economy been orderly? Any objective appraisal of the period 1955 to date would lead to an answer in the negative. In 1955, we had a consumer boom featured by residential construction and by automobiles. In that year, we had 1 million 300 thousand housing starts and sold about 7-1/2 million new automobiles. In that year, 30 per cent of the increase in total debt, both governmental and private, was in residential mortgages. Consumer instalment debt increased markedly in volume as the terms of automobile paper were liberalized.

In the following year, 1956, total consumer spending increased substantially further even though housing starts fell 16 per cent to 1 million 100 thousand and the number of automobiles sold dropped over 20 per cent to about 6 million. Once again a large share of the rise in debt, public and private, was accounted for by residential mortgages--this time 42 per cent as against 29 per cent during 1955. There was also superimposed on rising consumer spending an extraordinary expansion of plant and equipment. Such spending was 22 per cent larger than the year before. Perhaps it was prompted by the consumer boom, perhaps by the faith that demand would expand unceasingly because of population growth and technological advance. Some plants were built because of the expectation that building costs would continue to rise year after year and that the sooner the building was undertaken, the lower the total cost. In any case, confidence turned into ebullience that induced miscalculations and imprudent decision-making. The result of all this was excess capacity and cost-price dislocations. The latter have led to a profit-squeeze for some manufacturers and to price resistance on the part of some consumers.

In short, the growth of the economy has been disorderly and has led to imprudent decisions, wasteful and inefficient practices, some prices that are unacceptably high, and a degree of unemployment that is of general concern. Apparently, the seeds of the current recession were laid in the 1955-57 boom. Whatever steps are now taken to enable the economy to regain its health, certain misconceptions that may have accentuated the boom need to be recognized.

One misconception that is part of our intellectual currency is that a little inflation is a good thing. A little inflation, sometimes thought of as roughly 2 per cent a year, would double the price level every 35 years. It is not possible to control just a "little" inflation. Once the community accepts the prospect of continued inflation and begins to make its business decisions in the light of that prospect, the infant ceases to creep. It learns to walk, run, and finally gallop even though the gallop may carry it over the brink of the precipice that everyone agrees must be avoided.

It is a traditional view that debtors are benefited by inflation and that sound or hard money is detrimental to their best interests. Debtors are led to believe that a little more money, in whatever form, be it fiat money in France or Civil War greenbacks here, would enable them to pay off their debt obligations more readily and have more money to "spend". And in fact this is the case. What is not made clear by the Mirabeaus and Bryans is that the disadvantages of the process far outweigh the advantages to those very people who unthinkingly join the clamor to give them more money.

Another misconception is that inflation is inevitable. The belief that creeping inflation is inevitable is both self-defeating and dangerous. It is self-defeating because it is the rational foundation for escalator clauses that tie wage rates to the cost of living and accelerate the wage-price spiral. This leads some company executives to believe that if they are going to need more plant capacity they had better get it before construction costs rise further, thus bringing on the very malady they dread. It is dangerous because it has an insidious effect upon the quality of decision-making by businessmen. They feel that it is better to err on the side of overbuilding and thus keep up with the competitive Joneses for creeping inflation will tend to make miscalculations of capacity look like canny decisions.

This brings me to a final misconception: that inflation can be stopped without inconvenience. This is the fallacy that most hampers any serious effort on the part of responsible authorities to preserve the stability of the economy. To control inflation, we must avoid spending more than we earn in production, which means restraining demand by delaying some expenditures. In the long run, investment must be financed either by taxation, or by real savings from current income if the advantages of a stable dollar are to be achieved.

The decade of the sixties is one to which we can look forward with hope if we can avoid the perils of war and of inflation. The second, and perhaps the first peril, requires wise, far-sighted financial husbandry. There have been few periods in history when people--intelligent people, too--have not despaired of the future of their institutions. They have been beset by grave perils before. Yet one cannot read the history of free men without renewed faith in their capacity to rise to the occasion when stark necessity demands it. And one cannot study our own history without increased confidence in the good sense of the American people, and in their willingness and ability to make and accept hard decisions. There is truth in the Chinese proverb: "All the flowers of all the tomorrows are in the seeds of today."