For Release on Delivery

Approximately 5:15 p.m.,
Pacific Standard Time,
Thursday, February 26, 1959.)

THE QUALITY OF DECISION MAKING

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At the Management Program, Junior Chamber of Commerce,

San Francisco, California,

February 26, 1959.

THE QUALITY OF DECISION MAKING

It is my purpose to discuss the quality of decision making both in business and in our economic affairs, and to draw my illustrations primarily from the latter. As a text I shall use the concluding sentence of Chairman Martin's recent testimony before the Joint Economic Committee: "The state of the nation tomorrow--its progress and prosperity--rests with the decisions of today."

In skeleton form the points I shall make are as follows:

(1) Policy decisions flow from the main purposes it is hoped to achieve.

(2) A policy decision is not an island; each is influenced by a stream of decisions that have preceded it; in turn, each will influence decisions that must be made in the future.

(3) Decision making of high quality involves coordination, timing, balance and proportion.

(4) Certain organizational axioms should be observed, but I shall not discuss them except to say that the areas of responsibility should be defined and understood; the executive or agency that bears a given responsibility should have the requisite authority to make the necessary decisions; the executive to whom such authority is delegated should make his own decisions and not lean upon his superior in order to avoid blame.

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. Strong economic activity 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. Above all we pray for peace.

From these generally accepted goals, one may distil the three significant economic ones about which opinions differ widely:

(1) To foster orderly economic growth and to sustain employment at the highest feasible level.

(2) To protect the purchasing power of the monetary unit.

(3) To keep international payments in balance.

When nations seek to translate economic objectives into policies and to implement these policies with concrete programs, conflicts of interest are likely to be encountered. For example, a number of nations have been forced to slacken their rate of domestic growth in order to balance their international payments.

Healthy growth of the economy, the Number 1 goal, can be attained only by a close gearing of bank credit expansion with that of the economy generally. It requires that the central banking system provide enough but not too much money to achieve and maintain balanced growth without inflation.

The second one, to protect the purchasing power of the dollar while providing widespread employment opportunities, is needed both for the benefit of those who live on fixed incomes and of those who must have steady employment.

The third goal, external equilibrium, is one that American citizens are just coming to appreciate. It is related to our ability to remain competitive enough to export our goods and to compete with firms in other countries that have now obtained equipment and "know how" equal to our own. This third objective affects the job opportunities in industries that must compete with foreign firms for business abroad or at home. It is also related to the confidence in the dollar that is held by the investing community.

These three objectives are approached differently by different nations depending upon their memories of recent experience. Britishers, despite years of distressing unemployment and reliance on the dole, have come to understand that their firms must remain competitive if they are to export, and that unless they do export, they will not prosper and Britishers will not live well. In Germany the guarding of the monetary unit is now a cardinal principle because the suffering during the inflations in the 1920's and 1940's, with the destruction of savings and of individual liberties, was so deeply impressed upon the German consciousness. In our own country, however, it is a long time since its citizens suffered from wild inflation. Their subconscious thinking does not react to the concept in terms of human suffering; rather it is the unemployment of the 1930's that causes the national thinking, even to this day, to stress the sufferings of unemployment. It seems that our own country must learn from the experience of others that inflation and unemployment are both threats and that flirtation with the first does not avoid the second.

Monetary and Fiscal Tools and Those Responsible for Using Them

In this country the responsibility for carrying out monetary policy rests with the Federal Reserve System. Its monetary tools are open market operations, which means buying or selling in the open market Government securities held in its portfolio; discount rates, which are the interest rates paid by member banks of the System when they borrow from the Federal Reserve as a bank of last resort; and reserve requirements, which are a prescribed minimum percentage of a bank's deposits required to be held as deposits in a Reserve Bank.

Fiscal policy embraces debt management, taxation and governmental expenditures. Debt management is the primary obligation of the U. S. Treasury, whereas changes in the form and rate of taxation are the ultimate responsibility of the Congress, as is the appropriation of government funds. Although the executive branch initiates most changes in revenue and expenditure, and determines the rate at which appropriations will actually be spent, Congress has the constitutional responsibility as to the levying of taxes and spending by the Federal Government.

Current Problems of Monetary Policy

I will discuss first the area of decision making with which I deal most closely: monetary policy formation within the Federal Reserve System. Our country is now enjoying a considerable degree of prosperity. Consumers are buying briskly. Business spending is also up. The scale of demands on the capital markets indicates that plant and equipment expenditures are likely to be well maintained. The stock market is buoyant. With so much vigor in private credit demands and with the persistence of inflationary psychology, it would seem that the Federal Reserve had a reasonably straightforward problem to solve. This simple view, however, fails to allow for a number of other economic factors. For one thing, the Treasury is going to be borrowing in the market a number of times during the course of the year. There will be a steady demand for funds not only from corporate borrowers but also from State and local governments. The projected trend of housing starts suggests that a continuous demand for mortgage funds is likely to prevail. The amount of unemployment that has continued in spite of a revival of business activity is sobering. We cannot be satisfied with our economic progress while we are not using our resources fully and productively.

Certain current Federal Reserve problems stem from decisions that were made more than a year ago. Since one of the basic functions of the System is to supply banks with reserves that will provide the level of credit and money that is in keeping with economic needs, the purpose is to supply neither too much credit nor too little.

But there were practical difficulties in implementing such a policy in last year's recession and after. The supply of money expanded very rapidly from February to August. If money supply be measured by currency and demand deposits, the annual rate (seasonally adjusted) was about 8 per cent. For those who prefer to include time deposits in their definition of money supply, the rate of expansion was even more rapid. During the second half of the year the return of active business caused the Reserve System to moderate the rate of increase in the money supply so that the increase for the entire year 1958 was about 3-1/2 per cent. Was this sharp increase in the money supply to offset recession of the appropriate amount or did it exceed the needs for stable growth?

Another problem faced by the System is to balance the total of legitimate demands on the capital markets against the total flow of saving. If these needs cannot be met substantially out of voluntary savings, there is no alternative except to disappoint some borrowers--or to permit an inflationary over-expansion of bank credit. How much bank credit is needed for inventories? Can all of the corporations wishing to borrow meet their needs? Can State and local governments get their requirements? What part of the Treasury borrowings should be on a long-term basis? Can house buyers secure mortgage money from the normal flow of savings?

Influence of Past Actions

Since the situation now facing us represents the result of a number of earlier decisions, it may be worth while to look at some of the background of our current situation.

The Treasury is in the market for funds because of fiscal decisions made in the past. We are all aware of the circumstances that have given rise to large national defense expenditures. Although hindsight judging may be unfair, the fact remains that because of the upsurge of demonstrated Russian strength, the nation embarked on hasty crash programs. At the same time, non-military Federal expenditures have also increased, partly as the result of favorable growing weather, partly as the result of governmental actions to offset recession. In short, the deficit that now has to be financed arose out of decisions made about a year ago. For some time in the future we will have to live with the fiscal decisions now being made.

It is illuminating to observe recent history in still another area of decision making: that of business capital expenditures. In the year 1955 we enjoyed a very high level of consumer expenditures for automobiles, for housing, and for many durable goods. Businessmen, encouraged by this strong market, made capital expenditures based on a projection of these demands into the future. Thus a high level of such expenditures sustained the level of economic activity in 1956 and part of 1957, even though consumer expenditures for automobiles and housing had receded. The falling off of business capital expenditures in 1957 clearly accentuated the rate of recession.

By the same token, the inventory policies that had seemed appropriate in the light of the peak business volume were found by the Fall of 1957 to be out of keeping with real needs. And so there began a period of rapid inventory liquidation.

Many of the currently prevailing prices and wage rates also represent decisions made long ago. We are not sure of the extent to which the continued rise in prices even during the recession represented such lag defects. But price rises during a recession are certainly no help in curing it. It may be that sluggishness in certain markets today reflects price and wage decisions made during the recession.

Living with Past Decisions

It is not my purpose to be overly critical with respect to these past decisions. Nor can it be said that policy changes by the Federal Reserve have always been perfectly timed. The point to emphasize, however, is that the decisions of past years by both business and government have shaped the present fiscal and monetary situation. Current Treasury financing, price and wage developments, recent turnabouts in both capital expenditures and inventory accumulation are all the result of past decisions. Our present decision making will create, in turn, the atmosphere in which business is conducted during the years to come.

Current Decisions

The quality of business decisions is important at all times, but especially so during prosperity. In short, the duration of the current expansion will be influenced by the quality of decisions now being made by business executives. I am talking about the heads of manufacturing, mining and commercial enterprises, about farm managers and bankers--and about union officials, too. Unless the quality of this decision making reflects prudent judgment as well as a reasonably well-founded appraisal of present and future trends, executives will make mistakes for which they as well as their workers and investors will pay the penalty. What I am arguing for is that executives should risk neither too little nor too much; be willing to venture but still guard against unwarranted optimism.

The problem, of course, is how to balance insufficient protection against too much; to achieve a proper compromise between caution and enterprise, between conserving and expanding, between the safety of a strong cash position and the growth that borrowing makes possible. Proper balance requires that we not be overly cautious when times are bad, nor overly optimistic, to the point of imprudence, when they are good.

Business generally is prosperous. Much of it is on the highest plateau in history. What can executives responsible for policy making do to keep it so? Since the collective health of business reflects the experience of a variety of individual firms, the decisions affecting their future are vital to continued stable growth in consumption, production, and employment.

During a period of recovery such as we are enjoying, the greater volume of output, coupled with the economies introduced during the preceding slack period and the installation of new equipment cause output per man-hour to increase. As one would expect, therefore, last year's rate of manufacturing productivity grew faster than the postwar trend. It should be stressed, however, that as recovery is achieved, continued good times may tend to encourage wastefulness through inattention or imprudence. An attitude of "easy come, easy go" may lead to wastes of materials and manpower--wastes that would not be tolerated in times of adversity.

The problem is how to keep economic growth so orderly that industry and commerce can provide increased jobs, as well as a greater volume and variety of goods and services, without the interruptions that accompany violent dips. Steady, consistent progress calls for decisions of the best quality that business executives can make. Their decisions, if sound, will do much to lengthen the period of prosperity that the country is now enjoying. As Dr. Winfield Riefler has remarked: "A business situation is no better than the quality of the decisions that businessmen make."

The quality of decisions is, of course, a matter of judgment--for which there is no substitute. There has been and still is a good deal of discussion about the wording of the so-called mandate in the Employment Act of 1946. Yet in the final analysis what is most important is not the wording of the Act but the good sense of public officials, guided by its general language in making decisions.

Testifying before the Joint Economic Committee some years ago, Dr. Goldenweiser, former Director of Research of the Reserve Board, summed it up by saying: "There is no escape from judgment, and you do much better to emphasize and expend your energies in getting the kind of people who will use good judgment than in trying to devise a formula that will make judgment unnecessary."

Some Inferences

The freedom to make most of our own economic decisions is not only required by our decentralized 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 the homespun language of Will Rogers, "There is no 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 some one's sweat and by some one's saving. Chairman Martin has observed that "Lasting prosperity only comes from hard work, producing goods and services which people need and want at prices they are willing and able to pay." 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 so rich in promise and in hope. In the words of an old Chinese proverb: "All the flowers of all the tomorrows are in the seeds of today."