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INFLATIONS--THEIR LESSONS AND LOSSES

Remarks of C. Canby Balderston,
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The struggle to keep sound the monetary unit of a country is an issue centuries old. The Great Debate over fiscal and monetary policy is neither new nor novel. One may learn something about monetary management, both good and bad, from history. There are examples of the wise and disciplined use of fiscal and monetary policy. Within the last dozen years, three defeated nations, Austria, Italy and West Germany, whose economies had been flattened by war, have taught us anew that sound financial management is possible even under the most adverse conditions if a country has the will to achieve it.

I stress this encouraging note before reciting some history about fiscal and monetary mismanagement that resulted from the perfidy of kings and the cupidity of speculators. Though Rome had discovered the convenience and efficiency of the use of coin over barter, her currency was subjected to debasement after debasement. At times men clutched at bits of gold and copper as the sole realities in a crumbling world, and hoarded them. After the disruption caused by the dissolution of the Roman Empire, the use of money was slowly reestablished. Barter was again replaced by the use of coin. The right of issuing money was a special prerogative of the sovereign power, which claimed the authority both to coin money and to debase it.

In England, the Norman kings rarely tampered with the coinage, but Henry III began a process of debasing the currency, together with other forms of confiscation of wealth. The value of metallic currency suffered extreme changes in value just as credit currency has done subsequently.

For example, Henry VIII had inherited immense wealth from his father, but his love of display led to such cupidity as to reduce the amount of silver in the coinage to one-fourth of its face value. Rents and food prices rose; even clipped silver, despised at other times, became scarce because no one would lend what he believed would be repaid in baser money. Henry's successors devalued the currency so often that the people were robbed of half their savings.

Finally came Elizabeth. She had both the ability and the will to bring the silver money of England to a par with its gold money. But even while her government was preparing to suppress the circulation of base monies in England, a commission was granted to the chief officers of the mint to coin base money for the Irish. By this device the sophisticated English got rid of their base coin leaving the loss to fall upon the simple folk who were not in the know. Elizabeth flattered herself that she had settled English money upon a lasting basis; that she had, as she expressed it, conquered that monster which had so long devoured her people; but the subsequent history of England, and even that of Elizabeth's own reign, shows that though his power was checked, the monster was not annihilated.

The French inflations have been well-publicized and numerous. In the 1000 years following 768, the monetary unit of Charlemagne had declined to one-sixty-sixth of its original value. To illustrate how the livre depreciated during the last part of that period, the price of the gold mark in 1309 was 44 livres; four hundred years later, it was 576 (13 times as great). This was just before John Law, famed for his stock promotion called the Mississippi bubble, secured control of the French currency and ruined it completely.

Still another contribution to our knowledge of hyperinflations stemmed from the French Revolution. But it can be passed over here in favor of France's most recent experience that was halted in 1958 by firm measures retained by General de Gaulle. At the end of 1955, France began to exhibit evidence of how over-expansion of economic activity tends to increase inflationary pressure. To the world-wide surge in demand was added the inflationary financing of a large Government deficit of about 20 per cent of expenditures. Moreover, the bank credit extended to the private economy proved excessive. There followed inflationary results according to the classic pattern. Between January 1956 and July 1957, France lost over half of her official reserves of gold and dollars. Almost immediately, there was a *de facto* devaluation of the franc of 17 per cent. By the end of 1958, French prices were judged by the new de Gaulle regime as too high to compete in the markets of the world at the rate of exchange then in effect. Accordingly, the French franc was once more devalued--this time by 15 per cent.

It is illuminating to ponder recent history in our own country in order to distill from it whatever lessons it may teach us. In the year 1955 we enjoyed extraordinarily high 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, but without significant lowering of prices. Current price advances are therefore rising from a price plateau instead of a price valley.

Now for the lessons. You will pardon, I hope, their statement in cryptic form to conserve time.

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; its impact goes beyond 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 disrupts the productive process; even small doses of inflation are inconsistent with well-maintained productive activity.

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 create 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, even though the role of government has been progressively widened.

Government spending, however, 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 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.

As long as economic objectives are stated in general terms, there is 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 accepted objectives. Political and economic freedom are American hallmarks.

Monetary policy actions, however, must be specific, and decisions on such actions must be made in relation to policy objectives that are definite. These objectives take on their full meaning if translated into human terms.

I think of maximum employment as job opportunities for a family that has children of high school age who will be needing employment in the 1960's when the number seeking a start in life will be twice as great as in the early 1950's. The kind of realism that would help to provide such job opportunities now and later requires keeping American firms competitive by turning out products that people want, at home and abroad, and at prices they are willing and able to pay.

And the protection of the purchasing power of the dollar, I associate with the same worker and his wife, who will outlive him by 8 years. In addition to Social Security, these two are among the 14 million with pension rights under private plans, the 40 odd million who hold Government bonds, and the 112 million who carry insurance. These two hard-working people are savers, and both will be dependent upon savings.

Most of the day-to-day problems in economic policy making arise not out of differences as to objectives, but out of the choice of specific policies which will promote them. It is at this point that confusion starts.

It is asserted by some that a stable dollar and enough economic growth to provide an acceptable level of employment are incompatible. It is my own conviction, however, that price stability is necessary for high employment to be sustained over any lengthy period. Perhaps our most urgent domestic necessity is to protect the purchasing power of the dollar while providing widespread employment opportunities. Both for the protection of those who live on fixed incomes, and for the benefit of those who need steady work to support themselves and their families, we must--as indeed we can--achieve high employment without inflation.

Inflation is not an effective long-run means of creating job opportunities. But on this point thinking is confused. A recent letter asked "How can industry expand, buy machine tools and provide jobs for us millions of unemployed when you guys create tight money?. . . . Haven't any of you men got the guts to stand up for an expanding money supply and abundance of credit to encourage production and help make jobs?" A blunt answer to this heart-felt query is that the tightness of credit is influenced by the demand for it as well as by its supply, and that the mere running of the printing presses, or the ballooning of bank credit, do not foster productivity improvement and higher standards of living. Even when credit is under restraint, it usually is growing, but the proper idea is to keep its growth in line with the possibilities of increasing the "real" output of goods and services. In other countries, and even in our own, inflation fever has diverted trained ability from producing goods to speculating on inflating prices. Speculative activity does create some employment to be sure, but not employment that lasts. Eventually inflation endangers and disrupts job stability for it is during inflationary booms that the seeds of deflation are sown.

The rising investment demand stemming from industrial research and management initiative requires an increased flow of savings. If we are to remain competitive at home and abroad, we shall need both enough capital to implement technological advance, and competitive prices. While our products have improved, foreign-made products seem to have been improving even more rapidly. There is 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 seeking continuous increases in technological and marketing efficiency, while preventing costs from rising faster than compatible with those increases. Only thus will our firms remain competitive.

The problems of monetary policy are the problems of a society organized around the principles of free markets and freedom of choice. In an economy where freedom is exercised by individuals and by business units, effective regulation of the money system is of prime importance. In fact, the major concern of monetary policy in such an economy is to minimize the unstabilizing effects of changes in the use of money and credit that businesses and individuals generate in the exercise of freedom. But freedom, even though it entails flaws, is the well-spring of social and economic advance. It spurs the creative process; it permits experimentation leading to change. The resultant economic hazards are small prices to pay for the rewards.

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.