For Release on Delivery

(Approximately 6:30 p.m.,
Eastern Standard Time,
Tuesday, December 7, 1965)

MANAGING OUR MONETARY AFFAIRS

Remarks of C. Canby Balderston,

Vice Chairman,

Board of Governors of the Federal Reserve System,

Before the Pennsylvania Bankers Association
Lending Conference,

in Harrisburg, Pennsylvania

on Tuesday, December 7, 1965.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

MANAGING OUR MONETARY AFFAIRS

Charles Dickens' famous novel, A Tale of Two Cities, opens with a passage that has a grimly current ring:

> "It was the best of times, it was the worst of times,
>
> it was the age of wisdom, it was the age of foolishness - - -
>
> it was the spring of hope, it was the winter of despair."

Dickens used these words to describe the Europe of nearly two centuries ago, but some future historian could easily choose them to emphasize the dilemmas faced by America right now.

At home, we enjoy the physical basis for the good life; but abroad we suffer the tragic losses and costs of war. In our country, times are so good that only about 2 per cent of our married men are currently out of work; yet, with all our affluence, there remain pockets of cruelly disadvantaged citizens who live on a diet of bitterness or quiet despair. We bask in the warm glow of rising incomes and profits; but prices are creeping up, too, distorting income flows and eroding the value of savings. At home, we continue to save in unparalleled amounts; yet abroad, we lend and spend beyond our ability to finance, and have to pay for the difference out of our dwindling stocks of gold. And so, in the midst of great good fortune, our country has problems.

The most basic of these problems, you may say, are military, racial, or social, and are not the province of bankers as such. But I would remind you that financial influences pervade all these other issues, and are in turn influenced by them. Good stewardship in the management of the nation's financial and monetary affairs is vital to

LIBRARY

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

our country's safety and well being. It affects the adequacy and steadiness of jobs; it influences the security of savings.

In this country, as in others, there is continuing debate over conflicting concepts as to how best to manage financial affairs. The struggle is to discover the mix among these concepts that best meets the conditions at a given time.

In the management of financial affairs, a pivotal role is played by Federal Reserve monetary policy. Monetary policy, however, is effective only so long as it works in general consonance with the economic realities underlying the situation. These realities include the basic demands for funds, whether to meet seasonal needs or for long-run capital formation, and the supplies of funds provided through saving.

Federal Reserve actions cannot for long impose on the market rates of interest that are either much above or much below the rates that would maintain a balance between planned saving and investment without giving rise to serious deflationary or inflationary consequences.

The heart of the matter is to maintain the right quantity of credit and currency at a given time for a given economic condition. In short, I believe the monetary authorities should at all times seek to furnish the reserves needed by commercial banks to finance a high level of resource utilization without contributing to either inflation or deflation.

Inflation stimulates speculative ventures rather than those that are productive. The rise in speculative activity does create

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

employment, to be sure, but not employment that lasts. History tells us that, if carried far enough, inflation endangers and disrupts job stability.

In discovering how to protect the purchasing power of the dollar while widening employment opportunities, our country can profit by the experience of others. They have found that, while inflation and unemployment are both threats, indulgence in the first does not, in the end, avoid the second. Experience is a great teacher, but why is she so often late to school?

In the selection of methods to achieve desired monetary objectives, differences of view again can arise. Akin to the philosophic differences over the relative reliance to be placed on monetary policy is the question as to whether to use _general_ monetary guidance for the economy, or to resort to _selective_ controls. The former implies a form of governmental regulation, it is true, but only over the supply of credit in the aggregate, leaving the allocation of that supply to bargaining between borrowers and lenders. The alternative consists of detailed controls applied selectively to particular creditors or credit terms. Until recently, however, the only selective monetary control surviving in the U. S. was that over the flow of credit into the stock markets (_i.e._, margin requirements). Now it has been joined by a tax upon foreign borrowing in our capital markets.

In the past, it has not proven feasible to stop with just one of the family of selective controls. They are inter-related and one leads to another. Moreover, administrative difficulties have plagued all U. S. resorts to selective controls, whether to ration critical

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

materials and food through OPA, to restrain wage rates through the National War Labor Board, or to control mortgage and consumer credit terms through the Federal Reserve System. Even when supported by wartime patriotism, these selective efforts proved less than successful.

One of the major advantages of adherence to general monetary policies is the fact that it keeps the discipline of the market place at work on the terms and quality of credit. Individual borrowers and lenders must operate under that discipline if credit is to flow freely and productively. If a parody be permitted, it is important that the quality of credit be not strained. Avoiding such strain is an obligation not only of bankers, but of business executives and labor leaders as well who, after all, shape the terms of the basic contracts that demand financing.

In past generations, many forward-looking movements came to naught because of over-expansion and over-borrowing. Executive prudence is a valuable asset at all times, but especially during prosperity. Unless the decisions to borrow and to lend are based upon realistic appraisals of the future, the resulting investments may embarrass the bank and plague the borrowers. A loan never looks bad to a banker when first made; it just goes bad afterward.

The problem, of course, is to achieve a proper compromise between caution and enterprise, 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. Such a

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

balance is but one of the basic advantages that can accrue from decision-making that is widely dispersed throughout the economy.

It is a truism that there is no substitute for sound judgment. The practical problem is how best to bring it into play in the conduct of our affairs. How much do we bet upon the judgment of the many, expressed in the market place, and how much on the centralized judgment of a few? Centralized decision-making may sometimes be more expeditious, but when centralized decisions are in error, the consequences can be grave. Lord Keynes observed that "a democratic approach to public problems must stress the fact that economic totals are only aggregates of millions of parts which may differ from each other in more respects than they parallel each other. Mistakes made by individuals may offset each other but mistakes based on totals are likely to be aggregative and may be disastrous. . . . ." 1/

The economic freedoms that Americans cherish are part of freedom of enterprise --of freedom of choice in the conduct of one's affairs. The preservation of these freedoms, infinitely precious to all citizens, is a responsibility of us all.

The dispersion of business decision-making among a multitude of entrepreneurs has virtues not to be forsaken without deep thought and discussion. In only a few fields has our citizenry over the years concluded that the need for some central policy making was compelling. One example is our dealings with other nations; another is the regulation of the total supply of bank credit, as distinguished from its

1/ E. A. Goldenweiser, Monetary Management (New York: McGraw-Hill Book Company, Inc., 1949), pp. 2-3.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

allocation among users. In these areas, however, an especial degree of stewardship has always been demanded.

It is the task of the stewards of monetary policy to help create financial conditions that fit the needs of the economy and encourage businesses, individuals, and governmental units to make the kind of spending decisions that will contribute to stable economic growth with full employment. A key element here is maintaining an appropriate balance between growth in productive capacity and increase in consumption. But monetary policy cannot itself maintain economic stability if psychology should run rampant. It cannot lift business from depression in the face of general despair; nor can it prevent inflation if investment and consumption decisions lack the quality of prudence.

The essential task of both business and government is to stimulate the will to venture without producing the ebullience that leads to speculation and overcommitment. In the short run, the use of national resources for increasing productive capacity and for increasing the consumption of goods and services must be kept in balance. In the long run, the important consideration is to foster the highest sustainable level of economic growth without inflation so that productive capacity may keep up with the needs of an expanding population for both more goods and more jobs. The business and governmental decisions of this year will color the business situation next year and in the years beyond. There is truth in the Chinese proverb: "All the flowers of all the tomorrows are in the seeds of today."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis