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On Cutting Corners

Many years ago, in the wake of a tornado tragedy, a friend of mine was given the task of digging a double-size grave in the cemetery on the outskirts of my home town, Broken Bow, Nebraska. In those days it was a hand job and darkness had fallen when he finished. He threw his spade over the edge and then found, to his chagrin, that he couldn't climb out - it was too deep and the sides too steep. Finally, he curled up in a corner to wait for daylight. A few hours later, a nervous youth, in a hurry to get home, decided to cut a corner through the cemetery, and fell into the open grave. Frantically he tried to claw his way out of the dark, spooky hole. Suddenly he heard a voice from the far corner say, "Stop struggling, boy. You can't get out of this hole." But he did - and quicker than you can say "Caesar's ghost!"

One does not always end up in the hole as a result of cutting corners, and some who do are able to get out. But that does not make cutting corners any less objectionable - whether it be, for example, literally by trampling across someone's new lawn to save a few steps, or figuratively in business and public life by disregarding the letter or the spirit of the law in order to make a few dollars, avoid some inconvenience, or do a favor for someone.

The nation was recently appalled when the highest court of justice in the land was brought under a cloud by what can be described as corner-cutting proclivities. The questioned activities of one of its members were, in turn, related to the efforts of some wealthy businessmen to cut a few corners. First they decided to skirt the requirements of the Securities Exchange Act, and like the boy in Broken Bow, found themselves in a hole. In an effort to get out of it, they apparently elected again to cut corners by relying on "Washington influence".

Can there be any doubt that the nation has been spiritually degraded, with both the business community and our highest court a little tarnished, by this attempt to cut corners?

Of course, there is a certain amount of hypocrisy in our outrage at such things. One wonders, as he views the many examples of corner-cutting in our society, whether we all set the same standards for ourselves that we seem to expect others to live up to.

Consider, for a beginning, our ever so righteous angry young people - those of the younger generation who are prone to tar and feather their elders, verbally at least, for their failures and their hypocrisy. These youngsters tell us that our society is "no good". They say they want a society where human rights are respected, where honesty is honored, and where each man is accorded his just deserts. They sneer at us for our tendency to cut corners. Then they turn around and demand or support the demands of others that students be admitted to college who cannot meet the academic requirements, or they seek to dictate the course of study - tailoring it to fit the capabilities of those who are unable or unwilling to measure up to the established requirements. This is corner-cutting, with potentially serious consequences. I hope that the next generation will not have to drive on bridges designed by people equipped with engineering diplomas, but not equipped with a thorough knowledge of engineering.

The young are not the only corner-cutters. And, besides, they are the product of their environment. If we are unhappy about the product, we had better look into the climate that produced it. When we do so, we find plenty of evidence of corner-cutting.

I will not devote any time to the shortcomings of parents, only because they have been repeated ad nauseum fathers shortchanging their children, chiseling on their income taxes, et cetera. I am afraid that too often we are getting our satisfactions not from living up to our standards, but from breaking them.

Incidentally, there is something symbolic in the fact that the term "square", which has always borne a connotation of honesty and rectitude, has become expressive of contempt, with the connotation of being outdated and old-fashioned. If you cut enough corners, no one will ever call you a "square".

Our educators are pretty good at cutting corners, too. The college students complain that the burdens of teaching are borne not by the highly paid prestigious professors, but largely by student teaching assistants. The big name professors are off consulting or are too busy writing to be bothered with mere teaching. I understand that when one looks for a college teaching assignment, one of the objectives is to find the one with the least number of hours that one has to teach per week. The best "teaching" positions are those that involve the least teaching. You may have heard about the business executive who struck up a conversation with a college professor on an airplane. He asked the professor how many hours he taught, and the professor, exaggerating a bit, replied, "Ten". "Well", said the businessman, "that's a pretty long day, but then it is light work."

I have no way of knowing how much the students suffer from having been lectured to by a young graduate student instead of by a teacher holding some professional rank; but logic suggests that, at a time when the demands on our educational institutions are the heaviest in history and still rising, we have not succeeded in expanding the quantity of our higher education without an offsetting decline in the quality of the instruction.

The business world has long been notorious for corner-cutting. We may not agree with all of Ralph Nader's crusades, but there is no denying that he has put the spotlight on some rather glaring examples. A few years ago, Admiral Rickover took American industry severely to task for sloppiness in some of its workmanship.

On the other hand, I must confess a certain amount of amazement and admiration that an economic system which is essentially based on the competitive principle of trying to outsmart and outsell the other fellow generally succeeds in producing things that work so well. When we see the tremendous accomplishments of the Apollo Space program, which combines the technical skills developed in our institutions of higher learning with the know-how and precision workmanship of our industry, the management of a public agency, and the dedication, skill, and courage of those fine young men who fly the spaceships, we have to realize that there are a lot of people in this country who are not cutting corners.

I would be cutting corners myself, and thereby short-changing you, if I did not talk a bit about corner-cutting in the field of banking and in efforts to cope with inflation - a problem with great potential danger for the United States.

The corner-cuttings developed in recent months by bankers have been well publicized, if not always correctly labeled. They relate to the use by some bankers of various ingenious devices to avoid the necessity of saying "no" to big business customers - to avoid curbing credit expansion in response to restrictive monetary policies designed to curb inflation. Let me cite just three examples, although the list could be much longer.

(1) The sale of so-called commercial paper (an activity legally forbidden to banks) by one-bank holding companies, subsidiaries, or affiliates to raise funds with which to purchase loans from the parent bank, thus providing it with funds to continue expanding credit in a period when bank credit should be rationed - adequately and wisely.

(2) The solicitation of funds from a nonbank institution with a promise to lend them to another bank through the federal funds market and divvy up the profits (a device designed to enable a bank to do what is forbidden by law - to pay interest on demand deposits).

(3) The solicitation of deposits of public funds at rates in excess of the ceiling rates prescribed by Regulation Q, by having an officer of the bank (allegedly in his individual capacity) bid for the funds and then funnel them into his bank and elsewhere in fashions designed to provide him not only with enough of his bank's assets

to pledge as collateral for the public funds but also with a return high enough to enable him to pay the over-the-ceiling rate.

Corner-cuttings of these kinds can easily tarnish the image of the banks which are involved, but also, I am sorry to say, the image of banking as a whole; unfortunately, they also can make necessary additional restrictive measures for an industry already heavily restricted. The facts are not made any more palatable by the assertion that banks have been obliged to resort to such measures in order to live up to contractual commitments to lend - commitments given to assure "big" business customers that, come what may, they would be shielded against the impact of restrictive monetary policy or "tight money", that they would be able to obtain bank financing to expand even in times when expansion would not be in the public interest.

A recent survey of large banks revealed that in April the unused portion of such commitments amounted to 62 per cent of the entire loan portfolio of the reporting banks and 88 per cent of their aggregate business loans. Obviously, even the use of a fraction of those commitments would expand bank credit by billions of dollars, and not all of it would be used for productive purposes.

I hope those banks have now seen the handwriting on the wall and that such injudicious overextensions of commitments will not be repeated.

But corner-cutting is not confined to private institutions and individuals. It is indulged in by government, too. Take the subject of inflation, for example. The inflation we are suffering is certainly the result of a failure on the part of government to deal appropriately with an overheating economy, and I would not try to absolve the Federal Reserve of all blame for the way in which our economy has moved. We have made some mistakes - honest mistakes, but nonetheless damaging.

Fiscal policy has contributed to the problem, too. You will recall that it took many months of mounting fiscal imbalance before the policy-makers were finally persuaded that new taxes would have to be imposed if the federal government was to carry out all the tasks that it had taken on without bringing about an intolerable degree of price inflation. And many more months - nearly a year - were required to persuade Congress to enact the tax legislation in the face of strong and understandable voter opposition.

A tax increase is inevitably an unpopular move, since it affects each voter in an overt and immediately obvious way; as a result, both Congress and the public have voiced strong preferences for cutting expenditures as an alternative. This means of fiscal restraint clearly has a place in the government's kit of policy tools and perhaps it should be given more use than it has been in recent years, but only in the abstract is it politically more palatable than tax increases. In fact, nothing is more painful or difficult than cutting governmental expenditures, because every government expenditure represents someone's income. And while we all can be critical of spending, we all tend to be in favor of income - especially if it is our own, or our friends', or (in the case of Congressmen) our constituents'.

At any rate, after months of debate, we finally, in June 1968, got what the economists all thought was a respectable tax increase combined with a large amount of budget pruning. It was generally believed that this package of fiscal restraint would curtail inflation, a judgment shared by the Federal Reserve. Indeed, some were inclined to think that the dosage was greater than required. As a result, monetary policy was adjusted to ease the impact. It was not that we did not want to see inflation ended, but rather that we did not want to see the economy put into a tailspin in the process.

Our motives were good, but our judgment, or our forecasting, was poor. We did not allow adequately for the inflationary psychology that had already secured a strong grip on the public. Evidently convinced that prices were going only one way - up - the public, when faced with higher tax payments, preferred to reduce its saving rather than cut back on its spending. Our computers had not been alerted to this possibility, perhaps because we have no psychologists on our staff.

But now we are back on the right path toward stability. The Administration has stated in clear and certain terms that it means to halt inflation, and is acting accordingly. We at the Federal Reserve have made it plain that this is our objective, too. We have held the volume of bank reserves significantly below the amount needed to meet the still soaring loan demand, and as one result interest rates have climbed to record levels.

The effectiveness of our policy actions has been reduced by the development of new means of fund acquisition by banks, some of which I mentioned earlier, but even so, in recent months it has clearly begun to bite and credit is being rationed.

Success has also been thwarted, or at least delayed, by a credibility gap. With prices and wages still rising, with labor shortages plaguing employers, with production continuing to climb, with borrowers scrambling to obtain money even at unprecedented interest rates, the public has had a hard time believing that there is any virtue in curbing its appetite for goods and services. The old philosophy of saving for a rainy day has little appeal, especially to the younger generation that has never known a rainy day - other than the type that forces the cancellation of ball games. While now, at long last, bankers seem to have gotten the message, many businessmen are still not so sure that we really intend to take the steam out of the boom.

One reason for this credibility gap appears obvious from hindsight. In a sense, we have been cutting corners. We have been saying that we were going to move from inflation to stability, but intimating that this could be done without some inevitable unpleasant consequences: a slowdown in sales and an involuntary accumulation of inventories, which means a slowdown in production, less overtime and some reduction in employment, a squeeze on profits and smaller bonuses for management, and some weakening of stock prices.

History does not encourage us to think that, once a boom has gotten out of control to the extent that ours has, we can stabilize painlessly. Our successful operation in 1966, when a restrictive monetary policy did cool things down measurably - without bringing on a recession - was not painless. I see no reason to believe that success this time will be any less painful. I am not a masochist who wants pain for the sake of pain, nor do I think that we have some moral obligation to balance our pleasures with a dose of suffering. But I am persuaded that mass psychology is one of the most important factors influencing economic behavior, and fine tuning based on precise manipulation of fiscal and monetary policies will not succeed if it fails to take public psychology into account.

Our task now is to make people aware that it is in their best economic interest to restrain consumption and investment, and to cooperate in the effort to restore the soundness of the dollar.

Today, too many people are excessively confident, but it is confidence that inflation is going to continue, confidence that by cutting corners we can shift off onto the backs of others the painful aspects of fighting inflation.

What we urgently need to build is confidence of a different kind - confidence that we are going to have price stability; confidence that all of us - government, financial institutions, industry, labor, and the general public - will play our proper roles in the battle against inflation, without flinching, without cutting corners. True, this will mean a slowdown in business activity, but also it will mean less pressure on our resources, a rate of economic growth that will be slower but more sustainable, and a dollar that is not steadily depreciating.

Let me close with some words I read just the other night:

> "The energy of this nation is not to be controlled; it is at present exclusively applied to the acquisition of wealth and to improvements of

> stupendous magnitude. Whatever has that tendency, and of course, an immoderate expansion of credit, receives favor. The apparent prosperity and the progress of cultivation, population, commerce, and improvement are beyond expectation. But it seems to me as if general demoralization was the consequence; I doubt whether general happiness is increased; and I would have preferred a gradual, slower, and more secure progress."

Those words were written by Albert Gallatin, Secretary of the Treasury under Thomas Jefferson, shortly before the crash of 1837.

In the last year or so, I, too, "would have preferred a gradual, slower and more secure progress". I am confident that with wisdom and resolution we can get back to that path, without an economic cataclysm like the depression of 1837, but we will not get there by cutting corners.