KEEPING OUR DOLLAR SOUND

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It is always a pleasure to come back to my native State. In addition, your Executive Vice President, Lew Toyne, the man who invited me, was one of my former students whom I had the pleasure of teaching and coaching in freshman football at Aggies forty years ago -- so you will understand why I am doubly pleased to be with you this evening.

One of the greatest problems in the development of sound public policy today is the extent to which special interest groups press for what they think to be their own interest without recognizing or admitting the effect on the rest of the economy, of which they are inevitably a part. It is with this thought in mind that I approach the question which Lew asked me to discuss, namely, "How Do We Keep Our Dollars Sound?" I know of no simple answer, first, because of the differences in what we mean by a "sound dollar," depending upon our point of view, and, second, because of the many factors that have a bearing on its soundness.

But before going further with this question, let us look briefly at our broad economic objectives and the reason for wanting a sound dollar. As stated in the Employment Act of 1946, those objectives are "to promote maximum employment, production, and purchasing power."

The surest way to get sales expansion leading to expansion of output, and output expansion leading to expansion of job opportunities, is to offer the consumer more for his money -- to price consumers into the market instead of out of it. And the surest way of making that possible is to increase our productivity and for business and labor to share the resulting gains with the consumer, as business and labor should do, in their own long-term interest.

Increased productivity is basically the result of the substitution of capital for human labor -- whether this be in the form of investment in labor-saving machines, in research for better materials or methods, or in education and training of more skilled labor to develop and utilize the improved methods, materials, and machines. A sound dollar encourages investment in productive rather than speculative endeavors and also encourages the flow of savings needed to finance the investment.

In this connection, we should understand the nature and function of our dollar or, in other words, our money. Primitive economies can carry on their business by barter, that is, the direct exchange of goods and services but growing and highly specialized economies require a generally accepted medium of exchange as a yardstick for equating values of one commodity or service with another and also as a store of value. The inevitable time lag involved in the production, processing, storage, and ultimate distribution to the consumer makes it important that that medium of exchange have a stable value.

Here we should understand the effect of fluctuating dollar values on borrowers and lenders. Inflation, reflected by a rise in the general level of prices, means a loss in value of the dollar, and deflation, reflected by a drop in price level, means a rise in the value of the dollar. Hence, in periods of inflation the lender finds his loans being repaid in dollars of lesser value. To maintain his income, he tends to seek a more speculative lending market. The result is diversion of capital from essential needs and distortion of the orderly functioning and growth of our economy. Conversely, in periods of deflation the lender may profit momentarily by the repayment of his loans in higher priced dollars but if the

borrower is bankrupted by having to pay off his debts with these higher priced dollars the lender will have lost a potential customer for future loans. In other words, the old maxim that a successful business transaction is one that is mutually profitable to both parties to the transaction is best assured by a stable value for the medium of exchange.

But let us come back to the question of what we mean by a "sound dollar." Most of us would agree, I assume, that, as I stated above, a sound dollar is one of stable value as reflected by stable prices. But here we run into difficulty when we ask, "What prices?" Answers differ depending on who is observing and on what prices are rising. To farmers, rising prices for crops and livestock connote prosperity but it is inflation when prices for the goods and services they buy rise. I am exaggerating, of course, to make a point but, by and large, farmers, just as other groups in the economy, are pleased when the prices of what they sell rise but disturbed when other prices rise. This attitude is only human but it nevertheless points up the necessity of looking beyond our own immediate interests.

I do not mean to say that a rise in the price of crops and livestock is in itself inflationary. Clearly, it is not. We all know that agricultural prices are peculiarly sensitive to changes in supply conditions and that their fluctuation to a great extent reflects an alternation of relative scarcity with plenty. Other prices, too, vary depending on particular circumstances. Nonagricultural goods are less susceptible to the effects of natural phenomena on production but prices of those goods also are influenced by competitive pressures and changes in the public's preferences.

In fact, fluctuation in individual prices provides our most effective mechanism for the allocation of resources. Rising prices of any given commodity tend to stimulate its production while at the same time withdrawing productive resources from goods or services less in demand, always recognizing, of course, the lag resulting from the inevitable frictional resistance to such changes. This is especially true in the case of technological break-throughs that produce a new or improved product or a significantly cheaper cost of producing an existing product.

In this connection, as I stated earlier, it is advantageous to the consumer and to the nation's well-being when management and labor practices enable some of the benefits of gains in productivity to be passed along through lower prices, thus permitting more of the product to be sold throughout the nation -- to all citizens, not only to those whose incomes and earnings happen to be rising because of their place in the production process.

By stable prices, then, we do not mean individual prices which are necessarily in a constant state of flux reflecting these changing conditions of demand and supply and real costs within our economy. Rather, we mean the average level of prices for the whole gamut of goods and services which make up our daily life.

Thus far, I have dealt with what we mean by a "sound dollar" and why we need a sound dollar. Let us turn now to the factors involved in maintaining a sound dollar, or, in other words, stable prices. As I see it, there are three factors or groups of factors involved.

Factors making for a sound dollar

First, though not necessarily most important, I would list government fiscal policy. In years when governmental receipts, mainly from taxes, run short of spending, the government is in deficit, like anyone else would be, and has to increase its borrowing in order to finance outlays. In other words, it taps the nation's supply of savings. When governmental receipts run ahead of spending, however, the government adds its surplus to the supply of savings available to finance private investment. These are elementary relationships and they do not necessarily tell us whether governmental deficits are good or bad at any particular time.

Clearly, deficits are inflationary when the nation's savings are already being fully absorbed by the nation's private investment at high levels of national income and output. Then borrowing by the government to finance its deficits will lead to rising interest rates and to pressures for additional monetary expansion. On the other hand, surpluses are deflationary when there is not enough private investment demand to absorb the existing flow of private saving. Under those circumstances a governmental surplus will merely add to the oversupply of funds already in the market.

The fact that both governmental deficits and surpluses can have harmful impacts on the economy in certain circumstances requires judiciousness in the use of fiscal policy. It is not desirable for the Federal budget to contribute to a slowing of economic growth but excessive reliance on governmental deficits will tend to erode the soundness of the dollar. In brief, the Federal Government has to keep its demands on the economy within noninflationary bounds.

Next in factors affecting our dollar, I would list the decisions of management and labor regarding wages and prices because these have a potentially pervasive, cost-push effect on the general level of prices. It is perhaps unfortunate but nevertheless a fact that productivity gains are not achieved in all segments of our economy at the same time or at the same rate. Efforts by any segment to obtain wages or profits out of line with its contribution to national output will generate pressures in other segments. Such a cumulation of competitive wage pressures in less productive sectors can only be met through an extension of price increases, thereby exerting upward pressure on the general level of prices. Passing productivity gains on to consumers through price reductions has advantages to the economy, as I noted earlier, not the least of which is its role in dampening cost-push price pressures.

In recent years the average level of prices has not reflected significant upward price pressures, at least up to now. Wholesale prices have remained virtually unchanged on the average for several years. Whether they will continue to do so or whether recent and prospective labor settlements and other factors will tend to push prices upward, is a matter to be closely watched.

Despite the stability of wholesale prices, consumer prices have shown a small but steady upward movement for several years now. This is partly explained by the continued rise in price of services, such as for medical care and home and other maintenance. It is also partly explained as a result of an improvement in the quality of goods and services offered

the consumer. Whatever the validity of these explanations, the behavior of consumer prices has certainly given us no reason to relax our vigil even though the price situation as a whole may not have signaled the need for strong action.

But you will find that attitudes about the meaning and nature of the price situation differ and this brings me to the third factor affecting a sound dollar -- monetary policy. According to the Federal Reserve Act, the Federal Reserve System was created among other things "to furnish an elastic currency" or, in other words, a supply of money and credit geared to the fluctuating needs of a growing economy. And, as mentioned earlier, we have a responsibility under the Employment Act to "promote" among other things "purchasing power," which is best done by maintaining stable prices and a sound dollar. Too much money relative to the nation's productive capacity creates a demand-pull on the prices of scarce goods or services and a resulting rise in the general price level, even though prices on some items in abundant supply may be falling, an experience with which farmers are all too familiar.

On the other hand, with an inadequate money supply, credit essential to the optimum functioning of our economy becomes scarce or unavailable not only for investment in new or growing enterprises but even for major consumer purchases, many of which are dependent on credit today. Thus, with lessened demand, activity slows down,unemployment rises, and, theoretically, prices and wages fall. To the extent that this serves as a corrective for earlier excessive wage and price increases, this might be desirable. Unfortunately, under some of the rigidities and insulation from

competitive pressure that have been built into our economy, the latter rarely happens. Hence, it becomes doubly important that we attempt to guard against price inflation since there is little hope of correction during a contra-cyclical phase of the economic cycle. The objective of monetary policy, therefore, is to try to balance as accurately as possible the availability of money and credit to the needs of a growing economy at the optimum sustainable rate and at stable prices.

A Sound Dollar in Relation to Other National Goals

While I have been stressing up to now the relation of a sound dollar to prices, it would be a poor policy-maker indeed who focused on only one goal of national policy. In considering prices in relation to other national goals, some observers point to the stability of wholesale prices and say that monetary policy has been too vigilant in recent years, especially in view of the unemployment rate. Others point to the steady upcreep of consumer prices and wonder if policy has been vigilant enough, especially in light of our long continued adverse balance of international payments. These differing attitudes bring into relief the need to evaluate the goal of a sound dollar in the context of other national goals.

The stability of the price level has to be considered along with the economy's ability to grow at a rapid enough rate to raise our standard of living and to create employment opportunities for an expanding labor force. At the same time, no nation in today's world can concern itself only with its internal economic conditions. Every country must keep a watchful eye on its balance of payments with the other countries of the world. And, as you know, we have been running a sizable unfavorable balance for several years now.

Many people speak as if these goals -- a sound dollar, economic growth, and reasonable balance over time in our external payments -- were alternatives. That is, some would say that we may have to sacrifice a sound dollar for more rapid growth. And others would say that we may have to sacrifice domestic growth in order to better our international payments position. I do not think we should view these as competing goals. They are not alternatives but are interdependent. In short, you cannot really have one without the others.

One of the important factors that has helped sustain the current phase of economic expansion has been the environment of stability in which it has occurred. Thus, the expansion has not been characterized, at least so far, by such potentially damaging developments as widespread speculative build-ups in inventories or excessive investment in plant and equipment based on exaggerated expectations.

I do not mean to be saying that monetary policy can always successfully prevent price rises. What we certainly can and should do is to attempt to avoid feeding inflation. But there are times when price pressures, especially those generated from the cost-push side, will break through despite best efforts to hold them off. This merely illustrates that it is reckless to rely on monetary policy alone to bail out the economy once excesses have begun to build up. For the economy to operate effectively, all participants -- labor, management, farmers, and the various levels of government -- have to restrain themselves to their equitable share in their demands on the economy.

The provision of bank credit and money in amounts that encourage sustainable economic growth is itself a contribution to the return of our international payments to reasonable balance. In such a climate, businesses are encouraged to modernize plant and equipment and thereby to improve their international competitive position -- not to mention their ability to produce cheaper and better goods for domestic buyers.

Although the most publicized aspect of monetary policy's effort to contain the United States balance of payments problem has been the concern with short-term interest rates and capital outflows, the price stability of the past several years has been basic to the substantial improvement that we have had in the United States trade position. The improving international competitiveness of our industry, which enhances our ability to export and reduce our need to import, is fundamental to balance of payments equilibrium. Our stake in international trade is certainly large. And the stake of agriculture in that trade is also substantial. Exports of agricultural products amounted to around $5.5 billion last year or about one-fourth of our total merchandise exports.

If we tend to separate our objective of a sound dollar and subordinate it to other national goals, economic and financial problems inevitably become even more complex and more difficult to keep within bounds than they are. An extreme example of such a situation in this country occurred during and just after the second World War. To finance the war cheaply and to obtain the maximum production possible from the economy, we kept interest rates artificially low at the price of a tremendous build-up in the money supply. After the war we were still fearful for a time of

how a free credit market would perform and the policy of pegged low interest rates and monetary build-up continued. While these policies found justification in the exigencies of wartime finance, their by-products illustrate my general point. These by-products were price, wage, and rent controls, rationing, and during the early Korean period voluntary credit controls. Most of us will remember the complications, inequities, inconveniences and inefficiencies of an economy so fettered and will need no further explanation. Suffice it to say that the removal of a sound dollar objective from a central position in economic policy-making led to a profusion of economic controls as the government attempted to cope with the resultant imbalances.

More contemporary examples of inflation's fruits can be seen in those developing countries of the world which attempt to force growth by over-reliance on direct borrowing from the central bank -- in effect, just printing money to meet their bills. The growth so engendered seldom turns out to be sustainable, is almost always of little benefit to the people as a whole and is generally accompanied by sharp balance of payments problems, a loss of foreign exchange reserves, and the imposition of controls or multiple exchange rates in an effort to cope with the deteriorating external position.

In this country we have attempted to pursue a monetary policy aimed at achieving both our goals of soundly based economic growth and of balance in our external payments at the same time. We have attempted to do this because only in this way could we be sure of maintaining a healthy economy and avoiding the distortions that might lead either to undesirable fetters on a free economy or to a sharp recession in economic activity.

Let me conclude, then, as I began, by saying that there is no easy answer to the question of "How Do We Keep Our Dollars Sound?" The answer involves three major factors -- a sound, non-inflationary fiscal policy, sound and equitable wage and price decisions by labor and management as these affect the allocation of the fruits of increased productivity throughout the economy, and a monetary and credit policy designed to provide a money supply adequate but not excessive for an optimum sustainable economic growth at stable prices. It requires that these policies and decisions be arrived at in light of their effect both on our domestic economy and our international balance of payments problem, which are interdependent and inseparable. And, finally, it requires that each of us, as individuals or common interest groups, look beyond our own immediate apparent interest and consider our long-run interest and that of the economy as a whole, of which we are inevitably a part.