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GROWTH WITHOUT INFLATION

Address of C. Canby Balderston, Member,

Board of Governors of the Federal Reserve System,

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The long future of our economy is one of great promise. Fortunately, the good business being enjoyed on this side of the ocean has its counterpart abroad. European production, at an all-time high, has helped this nation emerge from last year's recession.

My analysis, however, is directed to the problems of this country alone. It has to do with the underlying factors that favor its industrial growth and expansion, with recently developed financial mechanisms, and with the avoidance of inflationary pitfalls that would endanger steady growth.

Among the forces destined to support the future expansion of business might be mentioned the high rates of population increase and of technological development. I will not discuss the former except to remark that in the first half of the 1960's the estimated average annual increase in the total labor force will be nearly 1,200 thousand as against 700 thousand each year during the first half of the current decade.

The rate of technological advance is so rapid that recent inventions would have staggered the imagination of either Leonardo da Vinci or Benjamin Franklin. Had da Vinci, when he sketched a flying machine nearly two and one half centuries ago, been gifted with ability to peer into the future, he could scarcely have convinced himself that the pilot of a 1955 plane would be able to travel faster than the speed of sound for a period long enough to encircle the earth, and have his cabin illuminated by a glass bulb while he talked with the ground and with surrounding planes. Nor could he have brought himself to believe that the pilot could peer through fog at objects on the ground, while those who were earth-bound and being observed from above could themselves watch a football game being played a continent away. This man was sketching a flying machine at about the time Columbus, with no less imagination, was exploring the unknown.

These changes have come with such rapidity as to make obsolescence a pervasive phenomenon. A Los Angeles nursery school teacher reports that when a four year old asked what a radio was, she found herself explaining it as television without a picture. But obsolescence is merely the price--the welcome price--of the rapidity of technical advance. If General Electric were to produce jet engines without carbide cutting tools, it would need five times the factory and machine capacity and five times the labor force. These tools not only outlast the toughest high-speed steel by as much as 100 to 1, but they save two-thirds of the man hours once expended by cutting at five to six times the rate. Already one type of production involved in making shells bids fair to be replaced by the extrusion method developed by the Heintz Manufacturing Company from an idea originated by German scientists.

It is only twenty-five years since the first carbide tipped tools were shipped by the General Electric Co. on a trial basis. If we turn from carbide steels to the steels cut by them, the technical advance is illustrated by what the design, weight, and construction of a present day automobile or plane would be if we were limited to the steels of only a few decades ago. Neither could we reach the oil now being pumped from deep wells, nor take care of the high temperatures and corrosive conditions to be found in oil refining and chemical manufacturing.

One chemical company, Carbide and Carbon, makes more than 350 different chemical products commercially. The farmer has new conditioners for his soil, disinfectants for his seed and spray materials for his orchard. His wife dresses herself in artificial fibers that satisfy her taste and gratify her vanity, even though they bring harder times to the wives of other farmers dependent on wool and cotton.

In fact the evidences of this great advance surround us in such profusion as to make our children blasé, and to dull their capacity to wonder. The reproductions at Williamsburg and Sturbridge of the facilities of the "good old days" drive home, even to the unimaginative, the sharp contrast in modes of living then and now. Not only has refrigeration displaced the icebox, and made obsolete the once familiar stories of the iceman, but lessened dependence upon the herb garden as well. To present fresh examples of the results of technical research, such as antibiotics, a submarine powered by atomic energy, or isotopes released by atomic fission, seems to relegate to a past era equally amazing developments, which I grew up without, and which are really very, very new: radio, radar, sulfa drugs, color television, and electric computers. We are just beginning to get the news of the adoption of such computers by a few companies, including General Electric, Metropolitan Life, and John Hancock, for use on pay roll, cost, and other computations.

If we turn to finance, its modernization is not confined to the introduction of mechanical devices. The field has seen great strides in the direction of financial stability. Witness the apparent strength and resilience of our financial structure to withstand shocks, whether inflationary or deflationary. Much of it depends upon our central banking system.

The main purpose of the central banking mechanism, the Federal Reserve System, is to help provide enough credit and money to foster a high utilization of the nation's physical resources, technical skills, and manpower without inducing inflation. It is toward this goal that Federal Reserve policy is directed. Maintenance of the right amount of credit and money at a given time for given conditions is at the very heart of the central banking problem.

It is a task that requires constant observation of the intricate money market mechanism and frequent--often daily--adjustments. It is not one that can be conducted on the basis of rigid, mechanistic rules, but involves questions of judgment. The requisite procedures and bases for decision are continually being studied and improved.

In addition, the funds of most depositors in commercial and savings banks, and of shareholders in savings and loan associations are protected by Federal insurance; stock market credit is regulated; a Federal agency is charged with the responsibility for protecting the interests of the private investor in the securities markets; and the emergency needs of the commercial banks for cash can be met by borrowings from the Federal Reserve.

Private financial mechanisms have also been introduced in recent decades that help promote financial stability and growth.

The direct financing of consumers has grown greatly. It enables individuals with low and middle incomes to acquire automobiles and household appliances with more facility and at moderate cost. In the main, such credit has been extended on a sound basis with adequate down payments and monthly repayments within the means of the purchaser, and geared to cover the total cost well within the life of the article acquired.

Secondly, term lending to business concerns has been developed by commercial banks, life insurance companies, and other institutional lenders. Such lending has tended to adjust the amount and character of the credit to the specific purpose of the borrowing, and to schedule its repayment over the earning life of the facility acquired. Commercial banks and commercial financing companies have provided additional higher-risk credit to business firms on the basis of accounts receivable, field warehouse receipts, and specific items of commercial and industrial equipment. This has aided small and medium-sized firms as well as marginal borrowers.

These newer types of business financing have tended to place more intermediate- and long-term funds in the hands of credit-worthy businesses; they have tended to make funds available on terms not only satisfactory to the borrower, but sound for the lender and the general economy. In addition to these private financing techniques, public credit agencies have stood ready to make certain types of direct loans to farmers and to deserving small businesses to fill gaps in the supply of funds from private institutions.

Thirdly, more of home-mortgage financing has taken the form of long-term, amortized loans, instead of short-term, single-payment loans. This development has lessened the borrower's risk of an unexpected demand for repayment or failure to obtain renewal. Like term-lending to business, this form of mortgage financing also gears the repayment schedule to the ability of the borrower to meet his obligations out of income. Moreover, the guarantee of mortgages has facilitated the development of a national market through which capital-scarce areas can tap the funds of those areas with an abundance of savings.

Finally, in foreign financing, there is the recent resurgence of bankers' acceptances. A revival, in this country, of a market for bankers' acceptances, as active as that of the 'twenties, would facilitate international transactions. Furthermore, it would help establish the structure of day-to-day financial relationships required as underpinning for long-term international lending and borrowing.

The problem of insuring growth without inflation involves a correct appraisal of the future rate of expansion that the economy can sustain. This appraisal needs to be made with as much precision as prophecy of future happenings will permit. Inasmuch as forecasting involves some projection of present trends, the analysis of the latter must be approached with realism and objectivity.

But appraisal of the future is not enough. To keep excessive optimism or ebullience in leash requires prudent judgment, and is the overriding obligation, not only of business executives and of labor leaders, but particularly of bankers. The latter have unusual opportunities to secure an overall view of the economic scene and possess exceptional experience and skill in dealing with risks.

In past generations, many forward movements that appeared to be solidly based were injured or destroyed by lack of sufficient caution and judgment to curb over-expansion and over-borrowing. What I am suggesting is that many of the great financial crises which have become part of our business tradition were the unhappy result of speculative excesses and a too exuberant granting and use of credit. Although many of these forward movements were soundly conceived and financed in their beginnings, they fell into difficulty later because of lack of prudence. It is superfluous to cite the historic cases of the bulbs of Holland, or the Mississippi bubble, or the railroad boom that preceded 1893, because many of you are old enough to have personal recollections of more recent crises. There was the Florida land boom ending in 1926, and the overborrowing abroad that spoiled our foreign lending between the two world wars, even though sound arrangements had been worked out initially between responsible governments and responsible banking houses. There was the stock market boom that was ballooned skyward by billions of dollars of credit until its sudden return to earth after October 1929. There were the difficulties encountered by the plan to merchandise mortgages during the 1920's. The latter illustrates how a scheme calculated to meet a definite need (and which would have contributed to the financial advancement of its time) was spoiled by a too-liberal appraisal of real estate values, and by the lack of appropriate amortization.

And so, in our current striving to provide healthy and continuing growth without inflation, we might ponder such questions as the following:

Is the quality of credit satisfactory in all areas of current expansion? Is the current rapid expansion of mortgage credit sustainable and sound? What will be its ultimate effect upon existing real estate values and the underlying debt? Is the extension of the principle of government guarantees in the mortgage area likely to pose for the Government future problems of real estate disposal? Is the public interest served when credit is granted to augment large personal corporate empires? Did the growth of credit, other than that readily identifiable as security loans to brokers, dealers, and others contribute to the recent rapid rise in stock prices?

My concern about questions like these arises out of the more basic question: How can we provide for continuing and healthy growth in the economy without inflation? The need for expansion of credit and money in a growing economy is obvious and needs no argument. There are many examples in history, however, and not too ancient history at that, to show how excessive and unsound credit expansion can thwart the development of a progressive economy. It is our common responsibility to employ such caution as will counteract wishful enthusiasms and permit the full flowering of an economy so rich in promise and in hope. A period of expansion offers generous rewards for courage and hard work, but of all phases of the business cycle it calls most loudly for the exercise of prudent judgment.