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Remarks of C. Canby Balderston,  
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THE QUALITY OF CREDIT IS NOT STRAINED,--OR IS IT?

Our economic life may be likened to an enormous river that flows without ceasing. Sometimes its progress is straight and placid, sometimes crooked and tumultuous. Those supported by this economic flow--and who is not--keep peering into the future to discover what lies ahead, both in the long distance and in the short.

Regardless of the risk of being proven a poor prophet, I will ask what a long view reveals. Among the trends that seem to me worthy of notice are three:

The first is the recent high rate of population increase--about 1.8 per cent a year as compared with less than 1 per cent in the 1930's. The most fundamental question stemming from it is whether we can provide our growing population with a constantly rising standard of living. I will leave the answer to this question to the future--noting only that our history has been characterized by a persistent upward trend, albeit with short-term irregularities.

One aspect of population growth is the number of households formed each year, which affects the construction of schools, roads, homes, and household furnishings. Even though household formation is expected to decline during the next few years from earlier high levels, population growth will, in the long run, bring about an increase in household formation. The average size of household has declined. It is estimated to have dropped from 4.93 persons in 1890, to 3.37 by 1950, and to 3.34 by 1954. For many decades the number of households has tended to grow more rapidly than the population. During the 1930's, the number of households added each year averaged about half a million; in the immediate postwar years, 1947 to 1950, nearly a million and a half. Since then, however, the rate has fallen to 835 thousand a year, and during the rest of this decade seems likely to run even lower, perhaps 600 thousand.

As to the impact of population growth upon the labor force, it is estimated that enough jobs will be required each year during the last half of the current decade to absorb about 900,000 additional persons, as compared with 700,000 in the first half. During the 1960's, the problem of job creation will become more than one-third greater for, during the early part of that period, the postwar babies will be seeking jobs at such a rate as to make the average annual increase nearly 1.2 million.

A second factor is the gain in productive capacity during and since World War II. This gain cannot be measured accurately but its magnitude is reflected in the investment in new plant and equipment. In the four years of

1947-50 American business spent over \$20 billion a year on new plant and equipment, and, in the four succeeding years, nearly \$27 billion annually. The latter is almost five times the figure for 1939. In short, in the years following the end of World War II, American business has invested over \$200 billion to replace, improve and expand its productive facilities. Even after allowances for substantial price increases since 1939 and for replacement of worn-out facilities, the net expansion in the physical volume of fixed capital has been tremendous. For example, steel capacity has been increased by over 50 per cent; electric power capacity, by about 150 per cent. While we are unable to measure accurately the resultant growth in total industrial capacity, the growth exists and is significant. I mention this factor both because of the importance of these resources in the event of war and because of the obvious social gains from our ability to create a larger pile of goods and services for consumers to enjoy. But this social gain is not without cost. As Emerson pointed out in his essay on Compensation, "Every sweet hath its sour; every evil its good . . . . For every benefit which you receive, a tax is levied . . . . Every thing has two sides, a good and an evil." For the manufacturer in a particular industry, growth in plant capacity may mean greater profit potential for himself, but increased competition within his industry accompanied by downward pressure upon prices. On the one hand, American business has enhanced its ability to create goods and services, which provides material benefits for all and a useful and potent brake upon inflation; on the other hand, it has stepped up competition. Excess capacity puts pressure on prices and in turn on costs. (Competition, of course, has been an integral part of the process by which new products have been introduced and distributed and by which gains in productivity have been disseminated throughout our economy.)

A third factor is technological development. Since World War I, the number of men engaged in industrial research has increased fifty-fold, and as Dr. Mees of the Eastman Kodak Co. has pointed out, technical advance has been accelerating at a rate that has itself been accelerating. Yet this has been a period very short in the history of mankind. In the dramatic language of Dr. Robert E. Wilson, Chairman of Standard of Indiana:

"Let us compress the supposed 500,000 years of man's development into 50 years. On this time scale, it took man 49 years to get over being a nomad-- even longer to get his first pair of pants. -- A few months ago a few men learned to write; two weeks ago the first printing press was built. Only within the last 3 or 4 days have we really understood how to use electricity.

"And within the very last day have come such amazing things as radio, television, diesel locomotives, rayon, nylon, sulfa drugs,-- electric computers -- 100-octane gasoline, color and sound in motion pictures. -- On our condensed time scale, jet planes, a dozen new antibiotics and hormones, and the release of atomic energy all came into the picture" in the last hour or two.

Dr. Wilson's portrayal of man's technical advance has the great virtue of simplicity. Too often worthwhile ideas become lost in academic language.

The point that Dr. Wilson is driving home is that technology is the most significant characteristic of our time. It is true, of course, that it has increased to awesome proportions man's ability to destroy himself, but it has also enhanced his ability to achieve a satisfying material existence. Even though critics may feel that people have become overly interested in gadgets, it is my belief that the physical facilities for living a good life that are made possible by technology increase the chances of millions to enjoy the comforts once reserved to kings.

In fact the evidences of this great advance surround us in such profusion as to make our children blase, 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. The rapidity of change has made obsolescence a pervasive phenomenon, and the price--the welcome price--of technical advance.

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 currency 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 currency at a given time for given conditions is at the very heart of the central banking problem.

President Woodrow Wilson, Senator Carter Glass, Paul M. Warburg, and the others responsible for the founding of the Federal Reserve System were sensitive to the delicate balance needed between public control and domination that would destroy the rights of individuals under our free enterprise system. Accordingly, they contrived a system whose structure is distinctive in central banking. It is partly governmental, partly private.

The System reflects in its design a touch of genius. Its founders recognized that the United States had a heterogeneous population, tremendous variety in its industry, commerce and agriculture, and a banking system that contained thousands of different units. Some of these were national banks, some not. Had the United States been as small as England, with just a few private banks whose heads could be brought quickly into conference around the same table, the solution contrived by the designers of the Federal Reserve would have been different. But just as problems of size and mass are reflected in the structural design of the short-legged hippopotamus and the long-legged giraffe, so are the problems of this country's banks and commerce reflected in the Reserve System. There is a legend in Africa that the giraffe was designed by a committee. So, in effect, was the Federal Reserve, except that the result has more symmetry.

Among the freedoms that American citizens enjoy is the freedom of enterprise. Like the former Chairman of our Board, Mr. Thomas B. McCabe, I look on the Federal Reserve System as one of its great bulwarks. It is my view that businessmen have a particular responsibility to see that the various aspects of that freedom are defended.

The point has been made by Chairman Martin that the philosophy of the System may be likened to the concept of trusteeship. Trusteeship involves obligations that extend beyond mere legality. It involves the highest ethical and moral standards in the carrying out of the mandate issued to the trustee. While that mandate is in force, it implies the courage to take actions, however unpopular they may be at the moment, that the trustee believes to be best for the country and its economy. Naturally, the "trust indenture" of which we are speaking, that is, the Federal Reserve Act, is not irrevocable because it may be changed at the will of the Congress.

In bringing about this trustee arrangement to deal with the highly complex problems faced by a central banking system, the Congress is to be credited with foresight in the degree of independence with which it has surrounded the System. The nuances of independence are not easily spelled out. They involve an opportunity, like that of the judiciary, to act objectively without favor and without fear, free of private pressures on the one side and partisan political pressures on the other.

As Dr. Winfield Riefler testified before a Congressional Committee recently, "the monetary and credit policies pursued by the Federal Reserve System in 1955 will continue to be guided by the philosophy embodied in the Employment Act, i.e., the nurture and cultivation of sustained economic growth and stability at high levels of resource use. In more concrete terms, this means that credit and monetary policy will be directed toward furnishing the reserves needed by the commercial banks to perform efficiently their function of financing the economy at a high level of resource utilization without contributing either to inflation or deflation, and without encouraging developments that will make for instability. So far as the cost and availability of credit are concerned, it means that the System will try to promote a pattern of finance that will find a market for the economy's savings in constructive activities. So far as the quantity of credit is concerned, it will work for a rate of growth in the active money supply appropriate to the growth in the resources available to the economy."

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 needs of the borrower. 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. Certainly there should be strong public support for the President's request to the Congress for permission to modify the down payment and terms of VA and FHA loans.

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?

You will note that my questions point to three areas:

- (1) Speculative fever generated by current stock market activity;
- (2) Automobile production at an annual rate in excess of sales expectations for 1955; and
- (3) Too easy mortgage credit leading to speculative residential construction that may outrun the demand for housing. (Present mortgage terms may demoralize people's sense of responsibility for debt, induce ill-planned and low-quality construction, and bring about a decline in real estate values.)

My concern over the quality of credit arises out of the more basic question: How can we provide for continuing and healthy growth without inflation?

Obviously the expansion of credit and currency should be adequate to sustain economic growth. There are many examples in history, however, and not too ancient history at that, to show how excessive and unsound credit expansion can thwart progress. 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 hope.