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**Remarks of J. L. Robertson
Member of the Board of Governors
of the
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"THE MYTH OF CREEPING INFLATION"

It is an unusual convention that can afford to have two Robertsons on its program - and I am not speaking now in a monetary sense. But I am sure your officers took account of the consequences when the invitations were sent out. I do not intend to spend any time trying to make clear whether you are listening to the Robertson from Broken Bow or the one from Des Moines. From my point of view, misunderstanding on that score could only be beneficial. Before I finish, you will realize why I have everything to gain and nothing to lose from a case of mistaken identity.

If you are at all like me, you are quite weary of speakers who point with alarm at a crisis that demands wise and strong action, and demands it now! In common with every nation in history, our country has been facing difficult problems for 180 years, and even though we would hesitate to claim they were all solved wisely, the United States has survived, we can say with due modesty, in pretty good condition.

A century ago our national problems were social and economic, as well as political, just as they are today. But as mankind has mastered the machine (or has been mastered by it), and thereby has almost obliterated limitations of time and space and has created a most complex and interdependent society, major problems arise more often, and must be dealt with more quickly if they are not to get completely out of hand.

This half-minute capsule treatment of the history of civilization is the background for a discussion of the national problem with which I have most familiarity - the problem of American monetary policy.

Luckily for our country and the rest of the world, some of the most fearful political and social crises do solve themselves, or do disappear, if they are left strictly alone. This is not true, unfortunately, with regard to monetary policy; that problem will not answer itself and also will not go away if we ignore it. Day in and day out the national economy is deeply affected by the availability of credit. If there were no monetary policy whatever, that would affect economic growth and stability (which means the national prosperity) just as powerfully as does the most carefully thought out policy - the only difference is that the former inevitably would do a great

deal of damage and the latter, we hope, can make a major contribution to the country's economic welfare. So when we think about monetary policy, we are dealing with a problem that is fundamental and one that cannot be ignored.

Savings and loan associations are not creators of money. In carrying out your transactions you must use the money the Federal Reserve System and the commercial banking system have created. But you necessarily have a big stake in the proper solution of this problem.

A major objective of monetary policy is to maintain the stability - the purchasing power - of the dollar. The billions entrusted to savings and loan associations constitute one of the biggest segments of the savings of the American people, and a shareowner has been badly treated if the money he withdraws will buy significantly less than it would have bought a decade earlier when he entrusted it to your care. Your institutions would be derelict in their duty to shareowners if you took no part in the fight to see to it that the dollars you return are worth as much as when you undertook responsibility for them. And - from the selfish viewpoint - apart from the welfare of the people for whom you are, in a real sense, trustees, monetary instability always makes saving an unpopular pastime, which is never very good for the success of institutions like savings and loan associations.

Last summer the Senate Finance Committee started an "Investigation of the Financial Condition of the United States", which Senator Byrd described as "the first full-dress examination of our fiscal and monetary policies since the one conducted by the Aldrich Monetary Commission in 1908". The Byrd Committee hearings revealed that intelligent and sincere men in responsible positions hold extremely divergent opinions as to the proper role of monetary regulation in our economic system.

Some, bothered by the recent slackening in our rate of economic growth, seem to feel that maximum production is all-important, and that, without worrying very much about the effect on prices, available credit should be constantly increased in the hope that production can also go on increasing.

Other schools of thought concede that the price level should not be disregarded - that inflation is a "bad thing" - but argue that monetary restraint is the wrong prescription for the ailment. Those who are unfriendly to the business community accuse administered or allegedly monopolistic prices of being the prime cause of inflation, whereas those on the other side put the blame on labor unions that seek and obtain wage increases in excess of increased productivity. Both groups agree, however, that holding back demand by restraining commercial bank credit is the wrong medicine.

Not to mince words, I consider some of these contentions to be what lawyers call "special pleading" - that is, emphasizing the other fellow's responsibility for a bad situation and denying or disregarding one's own part in producing it. Other of these views seem to be in the nature of making the best of a bad situation. Some people believe our economic system has such a strong built-in "inflationary bias" that nothing can stop the long-term upward trend of prices, and feeling that this is inevitable they thereupon happily discover that it is all for the best after all!

I solicit your sympathy for the unfortunate Federal Reserve System, which cannot adopt any of these relatively simple positions - it cannot discharge its responsibilities by charging labor, management, or anybody else with malfeasance, nor can it accept the view that "everything is for the best in this best of all possible worlds" and float the economy on a tidal wave of Federal Reserve credit until it smashes against the jagged rocks.

In my opinion there is a substantial element of truth in the arguments of each of these "special pleading" groups. But recognizing the validity of some such claims brings us face to face with one of the initial difficulties of monetary policy - the difficulty of maintaining stability of prices if price advances in some areas are not matched by price declines in other areas. Price stability does not mean stability of individual prices but only of the averages; and it does not mean absolute stability of price averages in all phases of a business cycle.

Some individual price increases must be accepted as inevitable. To grow and attract capital a new industry

may have to offer a better rate of return than can be found in older industries. If a business wants to attract workers into a new area, it may have to offer higher wages than those prevailing in settled areas. But if individual price increases are not to increase the price level, they must be offset by price declines elsewhere.

This is where the rub comes. No one likes to see the price at which he sells his goods or his services shrink. Almost no one of us has the detachment to see such a shrinking as a part of the big picture. And yet this offset is a necessary condition for overall stability.

Rises and falls in general price levels are not only inevitable, they are positively beneficial in that they tend to prevent the pendulum from swinging too far in either direction. When a recession begins and demand begins to shrink, prices go down and that encourages more buying and consequently more employment; when demand begins to snowball during economic revival, prices begin to go up and this acts as a brake on accelerating demand while at the same time it encourages an increased supply that brings the economy back into balance. It is when prices advance despite adequate supply, as they have in the past year, that the price advance becomes pure inflation, and it is this kind of price advance that experience shows is anti-social and undesirable.

So it is that, particularly in a boom period, there are almost irresistible incentives and opportunities on all sides to increase the size of one's wedge of the economic pie through increased use of credit, higher wages, higher profits, and so on. Experience has proved that it is unrealistic, in such an economic climate, to expect people to exercise self-restraint sufficiently to control the "inflationary bias". Although we occasionally see rather astonishing acts of economic statesmanship on the part of an industrial corporation or labor union, by and large this is not the rule, and that is why the central bank and its monetary policy must perform, in boom times, a most important - and most unpopular - duty.

In theory, the Federal Reserve System can stop an inflationary trend in its tracks if it presses the application of its credit restraints hard enough. But if this

power is exercised too vigorously or too late, we run the danger of simply reversing the spiral and starting the economy down the other side of the mountain - with unfortunate and untold costs in unutilized capital and manpower - and, as we learned in the '30s, turning a depression upward is somewhat more difficult than restraining a boom.

If the men charged with formulating monetary policy had instantaneous, complete, and accurate information regarding the American economy, and also had the infinite wisdom to evaluate and apply that information precisely, delicate adjustments might be made from day to day that would furnish the country with exactly the amount of credit it needs to achieve our economic objectives - the objectives might not be achieved because of factors beyond our control, but the money and credit supply could be just right.

Unfortunately, information is not available on those terms, and even if it were, no men have the absolute wisdom to understand it perfectly and to make the necessary decisions without error. The most we can do - and this is what we constantly strive to do - is to get the best information we can as fast as we can, to understand and apply it as well as we can, and then to adjust monetary policy to the needs of the country as we see them. The American economy is not a test tube into which one can pour controlled and measured ingredients, and so it follows, time and again, that the formulators of monetary policy misjudge and are compelled to make adjustments later and more radically than would have been ideal, as we see in hindsight.

Perhaps it would be well to state again our economic objectives. A restatement of fundamental beliefs is sometimes like a renewal of faith: it serves to correct and refocus our perspective.

First, the basic objective of economic policy is to use our economic resources fully and efficiently. Secondly, we want to grow, preferably in the direction of a higher standard of productivity and of living. Thirdly, we want a reasonable degree of stability in over-all economic activity and resource use. Finally, we want price stability - a reasonable stability of average prices.

It must be recognized that these objectives may conflict one with another. Growth itself may sometimes seem to defeat the full use of resources. For example,

growth is often accompanied by considerable technological change, and that makes some kinds of capital equipment and human skills obsolete. The unemployment of these obsoleted skills and equipment seems to conflict with the objective of using all our resources. Furthermore, growth itself often makes it harder to achieve stability. The use of new technology as it becomes available may be quite unstabilizing for some sectors of the economy. In a dynamic economy it is unrealistic to expect straight-line productive growth or absolute stability of economic activity or prices.

When we set out to measure our economic accomplishments, we will get differing answers, depending on which of these objectives we emphasize. Only common sense - certainly no mathematical formula - can tell us how to blend these objectives. But the blending has not been shockingly bad in recent years; quite the reverse. We have kept our productive resources employed. Machines have been kept busy, and good men have been harder to find than good jobs.

Our economic growth has been quite satisfactory. The rate of growth has varied considerably from year to year. Sometimes we make giant strides. In other periods we must pause while we consolidate previous gains. But the meaningful point is that we have a strong drive towards improvement which cannot be impeded for long. The existence of broad and imaginative plans for new and better things gives me great confidence in future growth.

It is hard to pin-point the optimum level of economic activity. Sometimes we may have gone beyond it. When jobs get too easy to find and profits too easy to make, we lose some of the incentives for initiative, cost-cutting, and hard work. My impression is that the performance in this country has averaged out reasonably well - certainly better than some countries where overabundant economic stimulation and brimful employment have led to slack management and poor workmanship.

We can likewise be moderately proud of our record in the matter of stability. Considering the dynamic nature of our economy, we are bound to have some ups and downs. Those we have experienced during the postwar decade may not have been too high a price to pay for high-level production and employment - provided we do not

become so soft with the "ups" that we panic at the first sign of a "down".

This generally satisfactory performance, however, has been marred by recurring waves of price increases. To be sure, we can blame World War II and the Korean War for much of this, but the price increases of the past two years cannot be attributed to such nonrecurrent (we hope) events. Even more disturbing than the absolute increase in prices since 1955 is the creeping notion that continuing inflation is here to stay.

For several years we have seen high production, relatively full employment, and at times inflation, marching forward shoulder to shoulder, like the Spirit of '76. From a material point of view, the majority of the American people "never had it so good". In such circumstances, it is human nature to leave well enough alone. Some say inflation has seriously hurt only a relatively few so far, and if "mild" inflation and abounding prosperity go hand in hand, why should we try to separate them when so-called authorities tell us that prosperity cannot march ahead very far without the companionship of inflation? Even the orthodox concede that the inflation of recent years has acted as an economic stimulant, and why should we deny ourselves a reasonable amount of the stimulant because of the fear, perhaps quite unfounded, that the pleasures of social drinking will be followed by the agonies of alcoholism? The contention that "creeping inflation" is not only inevitable but even desirable is indeed a very attractive fallacy - a myth in the making - if we do not analyze it too closely.

I happen to believe, however, that the hardships inflation already has imposed on millions of Americans are unnecessary and unjustified. But even more important, I believe that continued "creeping inflation" is impossible.

There is no way to stabilize inflation. If we should support inflationary developments at any planned rate - creeping, walking, trotting, or any other speed - the fact would soon become evident to everyone. At once this would affect all economic calculations. Sellers of goods or services in strategic bargaining positions would try to beat the game by insisting on price rises even

larger than the planned rate of inflation. Buyers would offer little resistance in the belief that prices would be even higher tomorrow.

The American people are rapidly becoming more sophisticated regarding the financial facts of life, and I do not believe that the inflationary pace could be held at the "creeping" stage very long. If the American people generally become convinced that inflation is a permanent part of our economy - that the recent profile of modest ups and downs of economic activity must be overlaid by an expectation of what the economists call secular inflation - we are flirting with danger. The danger is that the pace of the boom will become so violent that it cannot be sustained and a serious depression will result.

The notion that creeping inflation can be held at that slow speed and not be converted into galloping inflation is false on psychological grounds. Almost everyone, no matter how fair-minded and dispassionate, feels that he is not quite adequately compensated for his efforts. The farmer feels the prices at which he sells his crops are too low, the worker that his pay envelope is too thin, the businessman that his profit margin is too narrow - and as for public servants, I can speak with feeling. With complete sincerity and conviction every one of us can argue the unfair inadequacy of our own income. In the end the only way to halt this race to get ahead of others is to have it encounter a barrier that it cannot surmount. Monetary policy can be such a barrier. It is not surprising, therefore, that monetary action is often unpopular.

Because of the widespread feeling of the inevitability of inflation, the Federal Reserve "money managers" face a particularly difficult and thankless task - the task of piloting the ponderous ship of national economy through the narrow channel between the sharp rocks of inflation and the shoals of deflation. If, on the one hand, we are more responsive to minor evidences of deflation than of inflation, it encourages the belief that we will validate all price and wage increases by furnishing enough credit base to support the higher levels - it does not take a psychologist to see the effect of such a belief on the minds of those administering prices and negotiating wages. On the other hand, we must avoid pursuing restrictive policies to the point where they bring about a general

recession - recent discount rate actions indicate quite clearly the unlikelihood of that happening.

To my mind, the prime monetary question before the country is still whether the prevailing expectation of continuing inflation can be dissipated without some drastic proof of its long-run impossibility. I hope that people can be made to see this without having it painfully demonstrated.

Financial institutions such as the savings and loan associations you represent can help in several ways to combat this danger. In the first place, credit-granting should be based on present price levels and not on the expectation of further inflation. Up to now, in the postwar period, the margin of security behind many credits has been widened by movements in the price level. In contemplation of a continuation of this, the amount and terms of credit have been unduly liberalized in too many cases. Credit policies that depend on the assumption of rising prices cannot pay off indefinitely.

Next, the aggregate amount of lending should be brought in line with the current rate of saving. Long-term loans should not be made on the basis of short-term borrowing.

Finally, savers have a right to some reasonable assurance that their interests will be protected. Savers have always tolerated fluctuations in the value of their money. But it is one thing to maintain the saving habit despite occasional unintended fluctuations, and quite another thing - and much less likely - to do so in the face of a planned, indefinite decline in the value of money. If savers are given assurances that they have powerful friends in the community working in their interest, they may continue to use the services of financial institutions like yours. Lacking this assurance, they may try to protect themselves by resorting to whatever means they think will do the trick.

Because I believe this fight to be yours as much as ours, I invite you to join the ranks both in fixing the policies of your institutions and in carrying the economic gospel to the American people. This fight may sometimes put your personal popularity in jeopardy. But in the end the only good money system is an honest one. When the issue is put in these terms, which is putting it in its true light, there is no other course.

