FEDERAL RESERVE BANK
OF NEW YORK

Fiscal Agent of the United States

[Circular No. 4501
August 27, 1957]

RESULTS OF BIDDING FOR 92-DAY TREASURY BILLS
DATED AUGUST 29, 1957

To all Incorporated Banks and Trust Companies, and Others Concerned, in the Second Federal Reserve District:

At the time of printing our Circular No. 4500, dated August 27, 1957, announcing an offering of 91-day Treasury bills, to be dated September 5, 1957, the results of bidding for the previous week's issue of 92-day Treasury bills, to be dated August 29, 1957, and to mature November 29, 1957, were not available. The results, now available, are:

Total applied for	$2,469,456,000	
Total accepted	$1,800,655,000	(includes $325,278,000 entered on a non-competitive basis and accepted in full at the average price shown below)
Range of accepted competitive bids:		(excepting six tenders totaling $4,201,000)
High	99.115	Equivalent rate of discount approx. 3.463% per annum
Low	99.102	Equivalent rate of discount approx. 3.514% per annum
Average	99.106	Equivalent rate of discount approx. 3.497% per annum

(57 percent of the amount bid for at the low price was accepted)

Federal Reserve District	*Total Applied for*	*Total Accepted*
Boston	$ 38,508,000	$ 28,008,000
New York	1,725,227,000	1,177,637,000
Philadelphia	33,414,000	18,414,000
Cleveland	64,450,000	59,450,000
Richmond	19,356,000	19,356,000
Atlanta	44,947,000	39,147,000
Chicago	280,168,000	221,308,000
St. Louis	27,948,000	27,948,000
Minneapolis	14,357,000	13,671,000
Kansas City	60,894,000	58,134,000
Dallas	43,182,000	29,182,000
San Francisco	117,005,000	108,400,000
Total	$2,469,456,000	$1,800,655,000

ALFRED HAYES,
President.

at 4501

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK 45, N.Y.

RECTOR 2-5700

August 27, 1957

To the Chief Executive Officer of each Member Bank
in the Second Federal Reserve District:

On August 13, Chairman Martin of the Board of Governors of the Federal Reserve System submitted a prepared statement to the Senate Finance Committee, which has been conducting a study of fiscal and monetary policies. Mr. Martin's statement will be published in the August issue of the Federal Reserve Bulletin under the title "Winning the Battle Against Inflation." Since I am sure you are interested in this important subject I am enclosing a preprint of the statement as it will appear in the Bulletin.

If you should like to have additional copies for distribution to your associates or others, they are available on request to this Bank or to the Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington 25, D. C.

ALFRED HAYES,
President.

Enc.

Winning the Battle against Inflation

OUR COUNTRY has been experiencing a period of unusual prosperity, featured by heavy spending, both governmental and private. As a nation, we have been trying to spend more than we earn through production, and to invest at a rate faster than we save. The resulting demands, strong and incessant, have pressed hard upon our resources, both human and material. In consequence, prices have been rising, and the purchasing power of the dollar has been falling.

It is of the utmost importance to bring to bear on this critical problem all of the information and intelligence that we can muster. That is what you are seeking, and that is why this opportunity to appear here is timely and most welcome. We are not facing a new, or insoluble problem—it is as old as the invention of money—and history is marked with both defeats and triumphs in dealing with this invisible but deadly enemy of inflation. The question is not whether we can solve the problem, but how best to deal with it under our form of government and free enterprise institutions. Solve it we can—and must.

You have been inquiring particularly into fiscal policies and it is equally important to inquire into credit and monetary policies. They are closely interrelated, and are the two paramount and time tested means available to the Government in combating inflation. There are undeniably practical limitations of timing and scope upon both, but they are the most effective weapons in the arsenal against this destructive invader. In fact they are indispensable.

By way of preface and for the record I should like to outline first the general structure and organization of the Federal Reserve System. Then I want to go into the nature and character of the problems the nation is now facing.

FEDERAL RESERVE STRUCTURE

The Federal Reserve Act of 1913 was the outgrowth of prolonged Congressional study of the history of central banking in other countries and of our own experience, particularly with the First and Second Banks of the United States. The Congress, seeking to avoid either political or private domination of the money supply, created an independent institution which is an ingenious blending of public and private participation in the System's operations under the coordination of a public body—the Federal Reserve Board—here in Washington.

This question of "independence" has been thoroughly debated throughout the long history of central banking. On numerous occasions when amendments to the Federal Reserve Act were under consideration the question has been reexamined by Congress and it has reaffirmed its original judgment that the Reserve System should be independent—not independent of Government, but independent within the structure of the Gov-

NOTE.—Statement of William McChesney Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, before the Committee on Finance of the United States Senate, Aug. 13, 1957.

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ernment. That does not mean that the reserve banking mechanism can or should pursue a course that is contrary to the objectives of national economic policies. It does mean that within its technical field, in deciding upon and carrying out monetary and credit policy, it shall be free to exercise its best collective judgment independently.

The Reserve System is an instrument of Government designed to foster and protect the public interest, so far as that is possible through the exercise of monetary powers. Its basic objective is to assure a monetary climate that permits economic growth together with stability in the value of our money. Private citizens share in administering the System but, in so doing, they are acting in a public capacity. The members of the Board of Governors and the officers of the Federal Reserve Banks are in a true sense public officials. The processes of policy determination are surrounded with carefully devised safeguards against domination by any special interest group.

Broadly, the Reserve System may be likened to a trusteeship created by Congress to administer the nation's credit and monetary affairs—a trusteeship dedicated to helping safeguard the integrity of the currency. Confidence in the value of the dollar is vital to continued economic progress and to the preservation of the social values at the heart of free institutions.

The Federal Reserve Act is, so to speak, a trust indenture that the Congress can alter or amend as it thinks best. The existing System is by no means perfect, but experience prior to 1914 suggests that either it or something closely approximating it is indispensable. In its present form, it has the advantage of being able to draw upon the knowledge and information of the directors and officers of its 12 banks and 24 branches in formulating and carrying out credit and monetary policies.

Board of Governors. The Board of Governors, as you know, is composed of seven members appointed by the President and confirmed by the Senate, each for a term of 14 years. In appointing the members of the Board, the President is required to give due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, as well as the geographical divisions of the country. From among these members the President designates a Chairman and a Vice Chairman for terms of four years. Some of the functions of the Board of Governors are (1) to exercise supervision over the Federal Reserve Banks; (2) to fix, within statutory limits, the reserves which members banks are required to maintain against their deposit liabilities; (3) to review and determine the discount rates which are established biweekly at each Federal Reserve Bank, subject to approval of the Board in Washington; (4) to participate, as members of the Federal Open Market Committee, in determining policies whereby the System influences the availability of credit primarily through the purchase or sale of Government securities in the open market; (5) to fix margin requirements on loans on stock exchange collateral; and (6) to perform various supervisory functions with respect to commercial banks that are members of the System and to administer Federal Reserve, Holding Company, and other legislation.

Federal Reserve Banks. Each Federal Reserve Bank has a board of nine directors, of whom six are elected by the member banks. Of these, three are bankers, one from a large, one from a medium, and one from a small bank. Three more must not be bankers, but must be engaged in some nonbanking business. The other three members are appointed by the Board of Governors in Washington, which also designates one to be the Chairman and another the Deputy Chairman. None of these three may be an officer, director, employee, or stockholder of any bank. The directors of a Reserve Bank supervise its affairs. Subject to approval of the Board of Governors, they appoint the President and First Vice President. Subject to review and determination by the Board of Governors, they establish discount rates.

The stock of each Federal Reserve Bank is held by the member banks of its district. This stock does not have the normal attributes of corporate stock; rather, it represents a required subscription to the capital of the Reserve Bank, dividends being fixed by law at 6 per cent. The residual interest in the surplus of the Federal Reserve Banks belongs to the United States Government, not to the Bank's stockholders.

Federal Open Market Committee. The Federal Open Market Committee consists, according to law, of the seven members of the Board of Governors, together with five Presidents of the Federal Reserve Banks. Four of these five Presidents serve on a rotating basis; the fifth, the President of the Federal Reserve Bank of New York, is a permanent member of the Committee. Since June 1955, when its Executive Committee was abolished, this Committee has usually met at three-week intervals to direct the sale and purchase of securities in the open market. In practice, all 12 Presidents attend these meetings and participate freely in the discussion, although only those who are members of the Committee vote.

Federal Advisory Council. The Federal Reserve Act also provides for a Federal Advisory Council of 12 members. One is elected by the Board of each Reserve Bank for a term of one year. The Council is required by law to meet in Washington at least four times each year. It is authorized to confer directly with the Board of Governors respecting general business conditions and to make recommendations concerning matters within the Board's jurisdiction.

Judging economic trends. The work of the System requires a continuous study and exercise of judgment in order to be alert to the way the economy is trending and what Federal Reserve actions will best contribute to sustained economic growth. Such decisions are often hard to make because of the existence of cross-currents in the economy. Even in generally prosperous times, some parts of the economy may not fare as well as others. Credit policy must, however, fit the *general* situation and not reflect unduly either the condition of certain industries experiencing poor business, or that of other industries enjoying a boom. Residential construction illustrates this point. In 1956 and so far in 1957 demand pressures on available resources have been generally strong and prices have been moving up, but housing construction has receded considerably from its 1955 peak. The home-building industry undoubtedly could supply housing at a faster rate than is now prevailing. But even at the current volume, building costs continue to increase. The prices of some building materials have fallen, it is true, but the over-all cost of housing construction has increased appreciably even in the face of moderately lower demand. The explanation is to be found in the fact that expenditures for all major types of construction except residential have been maintained at or above record levels. This example shows why credit policy must take account of the over-all situation, and cannot be deterred unduly by special cases that are not typical of the whole.

Another factor complicating economic interpretation is that even in a period of broad advance and upward pressure on prices, there may be lulls when conditions seem to be stabilizing and the next turn of events is difficult to appraise.

Purposes. The objective of the System is always the same—to promote monetary and credit conditions that will foster sustained economic growth together with stability in the value of the dollar. This goal may be thought of in human terms. The first part may be considered as concerned with job opportunities for wage earners; the latter as directed to protecting those who depend upon savings or fixed incomes, or who rely upon pension rights. In fact, however, a realization of both aims is vital to all of us. They are inseparable. Price stability is essential to sustainable growth. Inflation fosters maladjustments. In some periods these broad aims call for encouraging credit expansion; in others, for restraint on the growth of credit. The latter is what is required at present, for clearly the most critical economic problem now facing this country is that of inflation, or put in the terms of the man on the street, it is the rising cost of living.

THE CURRENT PROBLEM OF INFLATION

This problem is far different from the one that beset us during the depressed 1930's, and left an indelible impression on our thinking. The problem then was one of drastic deflation with widespread unemployment, both of men and material resources. Today's problem has persisted through the years since World War II. It consists of inflationary price increases and the economic imbalances that have resulted.

This is the overriding problem that faces the Federal Reserve System today, for a spiral of mounting prices and wages seeks more and more financing. It creates demands for funds in excess of savings, and since these demands cannot be satisfied in full, the result is mounting interest rates and a condition of so-called tight money. If the gap between investment demands and available savings should be filled by creating additional bank money, the spiral of inflation which tends to become cumulative and self-perpetuating would be given further impetus. If the Federal Reserve System were a party to that process, it would betray its trust.

Conflicting views on causes. There is much current discussion of the origin of inflationary pressures. Some believe they reflect a recurrence of demand-pulls, similar to those present in the earlier postwar period. Others believe they originate in a cost-push engendered by administered pricing policies and wage agreements that violate the limits of tolerance set by advances in productivity.

These distinctions present an oversimplification of the problem. Inflation is a process in which rising costs and prices mutually interact upon each other over time with a spiral effect. Inflation always has the attributes, therefore, of a cost-push. At the same time, demand must always be sufficient to keep the spiral moving. Otherwise the marking up of prices in one sector of the economy would be offset by a reduction of prices in other sectors.

There is much to be said for the view that contractual or other arrangements designed as shelters or hedges from inflation have the effect of quickening its tempo. The 5 per cent rise in the cost of living which we have experienced over the last two years has probably reflected and been reflected in more rapidly rising wage costs because of the prevalence of cost of living clauses in many modern wage contracts. Cost-plus contracts tend to have the same quickening effect on the inflationary spiral.

The spiral is also, however, a demand spiral. At each point of time in the development of the inflationary spiral, there must be sufficient demand to take the higher priced goods off the market and thus keep the process moving.

The inflationary spiral. The workings of the spiral of inflation are illustrated by the economy of the moment. As has been brought out at some of the earlier hearings of this Committee, we are now faced with the seeming paradox that prices are expected to continue to rise, even though the specific bottlenecks in capacity that impeded the growth of production in 1956 have now been largely relieved, and investment in productive facilities continues at very high levels. Houses, automobiles, household appliances, and other consumer goods, as well as most basic materials, are all readily available—at a price. The problem is no longer one of specific shortages or bottlenecks causing prices of individual commodities to be bid up because of limited availability but rather it is one of broad general pressure on all of our resources. In other words, aggregate demand is in excess of aggregate availabilities of these resources at existing prices.

Taking the situation as a whole, as individuals, corporations, and governments proceed with their expenditure plans, buttressed by borrowed funds, they are in the position of attempting to bid the basic factors of production—land, labor, and capital—away from each other and in the process the general level of costs and prices is inevitably pushed upward. Recently, this general pressure has been expressing itself particularly in rising prices for services as compared with goods. Despite the existence in some lines of reduced employment and slack demand, many employers now face rising costs when they seek to expand activity by adding appreciably to the number employed. Often, the additional manpower required has to be bid away from other employers. As a result, many current plans for further expansion of capacity place great emphasis on more efficient, more productive equipment rather than on more manpower.

This generalized pressure on resources comes to a head in financial markets in the form of a shortage of saving in relation to the demand for funds. A considerable volume of expenditure is financed at all times out of borrowed funds. When these funds are borrowed from others who have curtailed their own expenditures, no additional demand for resources is generated. On balance, however, demands for funds by those who have wanted to borrow money to spend in excess of their current incomes have outrun savings. Those who have saved by limiting their current expenditures, and thus made funds available for lending, have still not kept pace with the desire of governments, businesses, and individuals to borrow in order to spend.

Just as an intense general pressure on available resources manifests itself in rising wages and prices, a deficiency of savings relative to the demand for borrowed money manifests itself in an increase in the price of credit. In such circumstances, interest rates are bound to rise. The rise in rates might be temporarily held down by creating new bank money to meet borrowing demands, but this, as I have said, would add fuel to inflation and bring about further increases in demands. In the end, as prices rose ever faster, interest rates could not be held down. In summary, whatever the special features of the current inflation, the important fact is that it is here, and that it has created demands for borrowed funds in excess of financial savings, even though these have grown appreciably. Any attempt to substitute newly created bank money for this deficiency in savings can only aggravate the problem and make matters worse.

EFFECTS OF HIGHER INTEREST RATES

The response to higher interest rates is complex. One result is that some would-be borrowers draw on cash balances to finance projected expenditures or lenders draw on their balances to lend at the higher rates, thus reducing their liquidity and increasing the turnover of the existing money supply. In recent years, with the large volume of Federal Government securities outstanding, many holders of these securities—both institutions and individuals—have liquidated their holdings in order to shift funds to other uses. This has been an important influence in bringing about the decline in bond prices. To the extent that accumulated cash balances or other past savings can be used more actively, expenditures remain high relative to available resources and prices tend to rise, but the reduced financial liquidity eventually exerts restraint on borrowing and spending.

Another result of higher interest costs, together with greater difficulty in obtaining loans, is that many potential borrowers revise or postpone their borrowing plans. To the extent that expenditures are revised or deferred, inflationary pressures are reduced.

The most constructive result is the encouragement of a volume of savings and investment that permits continued expansion of productive facilities at a rate consistent with growing consumption demands. Only in this way can the standard of living for a growing population be improved and the value of savings be maintained.

Such constructive adaptations, if made in time at the onset of inflationary pressures, need not be large in order to restore balance between prospective demands and the resources available to meet them. It is essential, however, that the adjustment be made. Otherwise prospective expenditures will continue to exceed the resources available and the pressure of excess demand will foster an inflationary spiral.

EXPECTATIONS OF CONTINUING INFLATION

Once such a spiral is set in motion it has a strong tendency to feed upon itself. If prices generally are expected to rise, incentives to save and to lend are diminished and incentives to borrow and to spend are increased. Consumers who would normally be savers are encouraged to postpone saving and, instead, purchase goods of which they are not in immediate need. Businessmen, likewise, are encouraged to anticipate growth requirements for new plant and equipment. Thus, spending is increased on both counts. But, because the economy is already operating at high levels, further increases in spending are not matched by corresponding increases in production. Instead, the increased spending for goods and services tends to develop a spiral of mounting prices, wages, and costs.

Unfortunately, during the past year, as price indexes gradually rose, some segments of the community apparently became reconciled to the prospects of a "creeping" if not a "runaway" inflation. One of the baneful effects of inflation stems from the *expectation* of inflation. While a price increase, in itself, may cause serious dislocations and inequities, other and more serious effects occur if the price rise brings with it an expectation of still other increases. Expectations clearly have a great influence on economic and financial decisions. In fact, decisions to spend or to invest too much in a given time are a direct cause of inflation. Also, if further inflation is expected, speculative commitments are encouraged and the *pattern* of investment and other spending—the decisions on *what kinds* of things to buy—will change in a way that threatens balanced growth.

"Creeping inflation." The unwarranted assumption that "creeping inflation" is inevitable deserves comment. This term has been used by various writers to mean a gradual rise in prices which, they suggest, could be held to a moderate rate, averaging perhaps 2 per cent a year. The idea of prices rising 2 per cent in a year may not seem too startling—in fact, during the past year, average prices *have* increased by more than 2 per cent—but this concept of creeping inflation implies that a price rise of this kind would be expected to continue indefinitely. According to those who espouse this view, rising prices would then be the normal expectation and the Federal Reserve accordingly would no longer strive to keep the value of money stable but would simply try to temper the rate of depreciation. Business and investment decisions would be made in the light of this prospect.

Such a prospect would work incalculable hardship. If monetary policy were directed with a view to permitting this kind of inflation—even if it were possible to control it so that prices rose no faster than 2 per cent a year—the price level would double every 35 years and the value of the dollar would be cut in half each generation. Losses would thus be inflicted upon millions of people, pensioners, Government employees, all who have fixed incomes, including people who have part of their assets in savings accounts and long-term bonds, and other assets of fixed dollar value. The heaviest losers would be those unable to protect themselves by escalator clauses or other offsets against prices that were steadily creeping up.

Moreover the expectation of inflation would react on the composition of savings. A large part of the savings of the country is mobilized in savings deposits and similar claims that call for some stated amount of dollars. If people generally come to feel that inflation is inevitable, they will not save in this form unless they are paid a much higher interest premium to compensate them for the depreciation of their saved dollars. It is for this reason that it is impossible, in a period of demand in excess of savings, to maintain lower interest rates through a policy of "easy" credit. The country is experiencing a period of generally high employment in which investment outlays remain high, but if fears of inflation cause people to spend more of their incomes and save less, the result could only be more rapid inflation and still less saving in relation to income. Such saving as remained, furthermore, would be less and less in the form of loanable funds to finance homes, highways, school construction, and other community needs.

Effects on productive enterprise. An inflationary psychology also impairs the efficiency of productive enterprise—through which our standard of living has made unparalleled strides. In countries that have had rapid or runaway inflations, this process has become so painfully obvious that no doubt remained as to what was happening to productivity. In the making of decisions on whether or not to increase inventory, or make a capital investment, or engage in some other business operation, the question of whether the operation would increase the profit from inflation became far more important than whether the proposed venture would enable the firm to sell more goods or to produce them at lower cost. The incentive to strive for efficiency no longer governed business decisions.

PRODUCTIVITY—KEY TO SUSTAINED PROSPERITY

Why have real wages in this country risen to the highest levels in the world, thus permitting our standard of living to rise correspondingly? Certainly, it is not just because wages have risen as the cost of living has risen. The big source of increase has been the increasing productivity of our national economy. Real incomes have gone up because the total size of the pie, out of which everybody receives his share, has grown so magnificently. What has enabled the productivity of the American economy to achieve the levels that make all this possible? One vital factor has been the striving by so many people, each in his own field, for better and more efficient ways of doing things. Equally important has been the willingness to set aside a part of current income to provide the machines, tools, and other equipment for further progress. Both are essential if our standard of living and material welfare are to go on advancing.

EFFECTS OF INFLATION

Inflation does not simply take something away from one group of our population and give it to another group. Universally, the standard of living is hurt, and countless people injured, not only those who are dependent on annuities or pensions, or whose savings are in the form of bonds or life insurance contracts. The great majority of those who operate their own businesses or farms, or own common stocks or real estate, or even those who have cost of living agreements whereby their wages will be raised, cannot escape the effects of speculative influences that accompany inflation and impair reliance upon business judgments and competitive efficiency.

Finally, in addition to these economic effects, we should not overlook the way that inflation could damage our social and political structure. Money would no longer serve as a standard of value for long-term savings. Consequently, those who would turn out to have savings in their old age would tend to be the slick and clever rather than the hardworking and thrifty. Fundamental faith in the fairness of our institutions and our Government would deteriorate. The underlying strength of our country and of our political institutions rests upon faith in the fairness of these institutions, in the fact that productive effort and hard work will earn an appropriate economic reward. That faith cannot be maintained in the face of continuing chronic inflation.

There is no validity whatever in the idea that any inflation, once accepted, can be confined to moderate proportions. Once the assumption is made that a gradual increase in prices is to be expected, and this assumption becomes a part of everybody's expectations, keeping a rising price level under control becomes incomparably more difficult than the problem of maintaining stability when that is the clearly expressed goal of public policy. Creeping inflation is neither a rational nor a realistic alternative to stability of the general price level.

"PEGGING" THE MARKET

It has been suggested, from time to time, that the Federal Reserve System could relieve current pressures in money and capital markets without, at the same time, contributing to inflationary pressures. These suggestions usually involve Federal Reserve support of the United States Government securities market through one form or another of pegging operations. There is no way for the Federal Reserve System to peg the price of Government bonds at any given level unless it stands ready to buy all of the bonds offered to it at that price. This process inevitably provides additional funds for the banking system, permits the expansion of loans and investments and a comparable increase in the money supply—a process sometimes referred to as monetization of the public debt. The amount of the inflationary force generated by such a policy depends to some extent upon the demand pressures in the market at the time. It would be dangerously inflationary under conditions that prevail today. In the present circumstances the Reserve System could not peg the Government securities market without, at the same time, igniting explosive inflationary fuel.

DO RISING INTEREST RATES ADD TO INFLATION?

We must be clear in viewing these relationships to distinguish cause from effect and not to confuse them. It is sometimes said that rising interest rates, by increasing the cost of doing business, lead to higher prices and thus contribute to inflation. This view is based upon an inadequate conception of the role of interest rates in the economy, and upon a mistaken idea of how interest costs compare with total costs. In municipal government budgets, it is about 2 per cent; in many utilities, it is 3 to 5 per cent. Thus, as an element of cost, interest rates are relatively small; but as a reflection of demand pressures in markets for funds, interest rates are highly sensitive. As previously explained, rising interest rates result primarily from an excess of borrowing demands over the available supply of savings. Since these demands are stimulated by inflation, under these circumstances rising interest rates are an effect of inflationary pressures, not a cause. Any attempt to prevent such a rise by creating new money would lead to a much more rapid rise in prices and in costs than would result from any likely increase in interest rates. Such an attempt, moreover, would not remove the need for a fundamental adjustment in the relation between saving and consumption and would probably fail in its purpose of stabilizing interest rates.

BASIC FACTORS IN RECENT INFLATIONARY PRESSURES

A major cause of recent inflationary pressures has been the attempt to crowd into this period a volume of investment greater than the economy could take without curtailing consumption more than consumers have been willing to do. In fact, there has been some increase in consumption on borrowed funds. Increases in interest rates naturally come about under such conditions; they are the economy's means of protecting itself against such excessive bunching of investment or the building up of an unsustainable rate of consumption. While the effect of a moderate change in interest rates on the cost of goods currently being produced and sold is small and relatively unimportant, changes in interest rates do assume importance as a cost in the planning of new investment outlays. These costs do not affect current operations or add to upward price pressures to any substantial extent. They do tend to deter the undertaking of new investment projects and to keep the amount of investment spending that is being undertaken in line with the economy's ability to produce investment goods. To maintain artificially low interest rates under these conditions, without introducing any other force to restrain investment, would be to invite an unbridled investment boom, inflation, and an inevitable collapse later.

It is necessary to emphasize that there are many influences, other than monetary policies and interest rates, that affect the volume of consumption, investment, and saving and their relationships. Monetary policies operate directly through the volume of bank credit and bank-created money. The volume of current saving out of income and the uses made of new and outstanding savings have a more important bearing upon the availability of investment funds than bank credit. Interest rates, therefore, are influenced by the relationship between investment demands and the availability of savings, independently of monetary policies. Interference with these relationships through monetary policies, in fact, may prevent necessary and healthy adjustments that help to maintain equilibrium in economic growth.

IN A NUTSHELL

A. An inflationary spiral is always characterized by:

1. An interaction between rising costs and rising prices; and

2. An increase in over-all effective demand sufficient to keep the spiral going. As prices generally keep rising, a larger and larger volume of demand (in dollar terms) is needed to sustain the same volume of transactions (in physical terms).

As long as it persists, therefore, an inflation will always show evidence of both demand-pulls and cost-pushes with their relative manifestations shifting as the inflation runs its course.

B. The tempo of interaction between rising costs and rising prices will be speeded up if the situation is characterized by:

1. The release of a previously created overhang of pent-up money demand (such as existed when direct controls broke down or were relaxed at the end of the war).

2. The creation in volume of new money demand through excessive credit expansion and/or activation of existing cash balances (such as happened when war broke out in Korea).

3. The widespread existence in the economy of escalators which act automatically to transfer rising costs or prices into rising prices and costs (cost of living clauses in collective bargaining agreements, cost-plus contracts, etc.).

4. The degree to which a speculative psychology backed by effective demand pervades business decisions.

C. The tempo of interaction between costs and prices will also be affected by the degree to which administered prices and wage rates are prevalent in the economy. These effects are not always in the same direction. The net effect of the many and various factors influencing administered prices and wages sometimes tend to slow up and sometimes to accelerate price movements, depending upon the particular circumstances.

D. Whatever the mix of the above ingredients, an inflation once under way will tend to persist as long as the credit necessary to finance the rising level of costs and prices is forthcoming. Credit may be supplied through new bank credit expansion or by activation of already existing money.

E. Whatever its antecedent characteristics, an inflation will tend to feed upon itself and be accentuated once the investing and saving public come to think of further inflation as the prospect.

F. It is the nature of inflation hedges to act as aggravating rather than equilibrating factors.

G. No one suffers more than the little man from the ravages of inflation.

H. A monetary authority dedicated to promoting the public welfare must not relax restraints in the face of continuing inflationary pressures, since any efforts to relax merely add to the forces tending to keep the inflation in motion.

WHAT MORE CAN BE DONE?

How, then, may further inflation be restrained? Bluntly, the answer is to be found in a moderation of spending, both governmental and private, until the demands for funds are balanced by savings. This prudence must be coupled with sound fiscal policy, which means a larger budget surplus as well as effective monetary policy to restrain the growth of bank credit.

Among the factors influencing saving and consumption are those fiscal policies relating to taxes and governmental budgets. These require special attention because they are not as responsive to changes in the availability of credit and interest rates as are private activities. Untimely fiscal policies can create or aggravate imbalance in the economy and thus dilute the effectiveness of monetary policies. On the other hand, fiscal measures that help to maintain balance can reduce the degree of restraint that monetary policies might otherwise have to exert.

Experience over the centuries has demonstrated that there is no tolerable alternative to adequate fiscal and monetary policies, operating in an environment of open, competitive markets under our system of human freedoms. Neither an economic dictatorship nor complacent acceptance of creeping inflation is a rational or tolerable way of life for the American people.

There is no panacea, no magical means of assuring orderly economic growth, nor are we much more likely in the future than in the past to achieve perfect performance in the timing and execution of policy and action. We have every reason to believe, nevertheless, that we can discern and follow the right path. Thus, it is clear that the present situation calls both for a larger budgetary surplus than we have had or have in prospect, and a continuance of restraint upon creation of new supplies of money.

ACTION REQUIRED

Let us not follow the defeatist path of believing that widespread unemployment is the alternative to inflation.

There is no question that the Federal Government and the American people, pulling together, have the power to stabilize the cost of living. The only question is whether there is the will to do so.

If the will is there, and it is demonstrated convincingly to the American people, the cost of living can be stabilized, interest rates will relax, and a sufficient volume of savings will be encouraged to provide for the economic growth needed in this generation and the next.

This Committee and the Congress can contribute greatly to that end by declaring resolutely—so that all the world will know—that stabilization of the cost of living is a primary aim of Federal economic policy.

The goal of price stability, now implicit in the Employment Act, can be made explicit by a straightforward declaration and directive to all agencies of the Government that anti-inflationary actions are to be taken promptly whenever the cost of living begins to rise.

The Executive and Legislative branches of Government, in conjunction, can assure adjustment of Federal revenues and expenditures so that, in times when total spending threatens to burst the bounds of capacity and drive up the cost of living, the Federal

Government will set an example of restraint in outlays and at the same time produce a surplus to counter inflationary pressures from any quarter.

The Congress and the Executive can take steps to assure that free and vigorous competition is maintained in all segments of the economy as the bedrock of our free enterprise system.

The Federal Reserve System, itself a creation of the Congress, can—and I assure you that it will—make every effort to check excesses in the field of money and credit that threaten the cost of living and thus undermine sustained prosperity and growth of our economy.

In all of these ways we can, if we have the will, set the face of the nation so resolutely against inflation as to keep that enemy from our gates.

No greater tragedy, short of war, could befall the free world than to have our country surrender to the easy delusion that a little inflation, year after year, is either inevitable or tolerable. For that way lies ultimate economic chaos and incalculable human suffering that would undermine faith in the institutions of free men.