STATEMENT OF J. L. ROBERTSON, MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, BEFORE THE HOUSE BANKING AND CURRENCY COMMITTEE, WITH RESPECT TO THE RECENT CHANGE IN THE DISCOUNT RATE AND REGULATION Q

JULY 22, 1963

Mr. Chairman, Members of the Committee:

I voted against a discount rate increase last week because I did not think it was worth the cost. Stated more fully, my view was that the probable benefit to the U. S. balance of payments resulting from a discount rate increase would be so small as to be considerably outweighed by its potential adverse effects on our domestic economic activity.

I am concerned that an increased discount rate and its consequences will create some dampening influences in what still needs to be a stimulative monetary environment here at home, given our high level of unemployment. At the same time, it is my judgment that the rate increase will have only trivial effects on international capital flows.

In the short-term capital area, it is quite conceivable that the increase in U. S. rates may be largely offset by compensating adjustments in foreign money market rates and forward exchange quotations. (This has been the general historical experience as between U. S. short rates and those in the United Kingdom and Canada, the two chief foreign money markets to which large amounts of money market funds can flow.) Furthermore, a major element in the short-term flows in the past has been bank loans abroad, and I would not expect these to be curtailed much by a discount rate increase alone so long as the basic availability of reserves is kept ample. In the area of long-term capital, we have a larger and more persistent drain on our hands. But the discount rate increase will not deal with this. An evident aim of current policy is to minimize any rise in long-term interest rates, and the differentials existing between foreign and U. S. rates of return on long-term credit and equity capital are so great as to far exceed the range of any moderate rate adjustment.

In pointing out the very limited influence on international capital flows to be expected from moderate adjustments in U. S. market interest rates, I do not want to be misunderstood. I am not discounting the existence of a balance of payments problem, but only the efficacy of a moderately higher discount rate as a weapon for dealing with it.

There is not any doubt but that we are living through a troublesome balance of payments situation, for a time, at least. It is not a problem of crisis proportions, but it is still one that needs to be dealt with through the application of appropriate remedies rather than devices designed to mask its effects or to serve as temporary palliatives. What is needed is a thoughtful but determined adjustment of governmental and private policies, at levels and in areas which will permit effective dealing with the persisting causes of the deficits. The President's message on this score last Thursday contained much that gave me heart. But the most directly applicable steps he advocated must be resolutely implemented, here in Congress and throughout the Administration. At all levels of government, we must carry through an "agonizing reappraisal" of our foreign aid and military objectives, and the extent to which they have to involve what are essentially unrequited dollar transfers abroad. We must strive even harder to knock down the barriers to our exports that exist in so many countries, denying us the full fruits of the real competitive strength that we have already achieved. Export promotion efforts at home can help, too, in this respect. But even more importantly, we must try to increase domestic business incentive, enriching profit opportunities, employing idle resources, both human and material, accelerating our rate of growth - all of which, taken together, will enhance the basic attractiveness of the U. S. as a place to invest. These call, above all, for an early tax cut and generally stimulative monetary conditions.

In other words, we must foster domestic economic expansion so that the attraction of U. S. funds for external placement will be significantly reduced. Economic developments in the U. S. have recently been encouraging. If expansive tendencies in the economy gain in strength, impelled in part by a tax reduction, gradual moderation in U. S. credit availability would be entirely appropriate. I say this because we know from past experience that at some stage of business expansion it becomes necessary for monetary policy to resist possible future speculative and inflationary tendencies with the view of maintaining a sustainable pace of economic growth as well as to keeping U. S. industry competitive internationally. This means we have the prospect that interest rates in this country would naturally move up, with an accompanying pressure of domestic demands upon supplies of funds that would help to reduce, curtail, or reverse flows of funds abroad. It is not fanciful to expect that, in only a few short months, a discount rate increase might have been entirely in order from both a domestic and international point of view.

But in the present state of economic conditions in this country, with high rates of unutilized manpower and machinery, monetary policy should be primarily oriented to a stimulative objective. Monetary policy is one of the most potent of all economic forces in this country, in good part because it is one of the most pervasive. It can be effective not only in dampening down booms, but also in warding off recessions. On the basis of past experience, I do not agree with those who maintain that we cannot "push on a string". If monetary policy had been used to its full power over the past two years in stimulating the economy, by providing such an availability of funds as to cause banks and other lenders to reduce their rates of interest in order to put idle funds to work, the stimulative impact would have been felt. This sort of stimulation, however, cannot be achieved if monetary policy is designed to hold up short-term interest rates on the one hand, while on the other it seeks to hold down long-term rates. The result is that both rates are higher than they should be for stimulative purposes, and the full potential of monetary policy as a stimulant to the economy is curtailed.

To state my views most categorically, I believe unnatural efforts at twisting short rates up can create domestic drags that can delay fundamental market adjustments, divert the focus of attention from the basic problems, and create a later backwash of reactions that can conceivably worsen our balance of payments statistics in future months.

There is no question but that the real basis of the world's confidence in the soundness of the dollar is not the gold in Fort Knox or the balance of payments statistics, but rather the underlying strength of the American economy. Hence, there is a compelling need for invigorating our economy, putting our people, our materials, and our money to work in an expanding, competitive, noninflationary environment, with a corresponding strengthening of the capacity of the United States to exercise its role of leadership of the free world.

In the light of these views, my judgment with respect to the desirability of increasing the discount rate at this time was different from that of my associates, and I was obliged to dissent from that action.

The discount rate increase having been adopted, however, the necessity of making an appropriate change in the maximum interest rates payable by commercial banks on time deposits was clear. Any significant advance in short-term market rates as a result of the discount rate increase would have rendered bank time deposits at the prevailing ceiling rates less attractive investments. The growth of the more interest-sensitive forms of time deposits might well have been halted or even reversed. During the past two years, rapid expansion of time deposits has led banks to substantially expand their investments in mortgages, consumer loans, and state and local securities, thus stimulating business activity and economic growth. If such credit flows from banks were abruptly cut back, the volume of funds available in long-term markets would be reduced and long-term interest rates would be pushed upward, with corresponding depressive effects on an economy that has still not attained an adequate level of performance. As a consequence, the wise course with respect to Regulation Q was to raise permissible rate ceilings to allow banks to remain competitive in this market for investible funds. This is the action that the Board took and in which I concurred.