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Objectives and Responsibilities of the Federal Reserve System

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It is a great pleasure to join you here today at the opening ceremonies of the Federal Reserve building that now graces the Twin Cities. The beautiful new home of your Federal Reserve Bank, with its truly unique architectural design, is the physical expression of the hopes and dreams of many people.

The Directors of the Federal Reserve Bank of Minneapolis were looking to the future when they chose the site for this building. They had the courage and vision to make this new facility an integral part of the Gateway Redevelopment Area. In earlier times, the Gateway was known as the entrance to the vast Western prairies. Today, this Federal Reserve Bank can be the gateway to a brighter and better economic future for all Americans.

The business leaders of this great metropolitan area played a prominent role in the planning and construction of the new building. Joyce Swan, the former Publisher of the Minneapolis Star and Tribune, was Chairman of the Board of Directors of this Reserve Bank through 1968. In that capacity, he directed the early planning for the building. The late Robert Leach, a highly-respected St. Paul attorney, succeeded Mr. Swan as Chairman of the Board, serving the Federal Reserve from early 1969 until his untimely death in December 1970. The present Chairman, David Lilly, played a substantial role in bringing the project to completion.

The man chiefly responsible for the new building, however, is the late Hugh Galusha, the former President of this Bank, whose career was cut short by a tragic accident in 1971. Hugh Galusha was a most remarkable man. He had the inquiring mind of a scientist, and at the same time the spirit of the frontiersman. He was venturesome, bold, joyous, and imaginative. He was not afraid of newness and challenge, as the unique structure to which he devoted so much of his energy indicates. His fine judgment led to the selection of the architect for the building -- Gunnar Birkerts -- and to the approval of its unusual design. He convinced skeptics at the Federal Reserve Board of the wisdom of his plan, and he did so in a gentle but persuasive manner.

Over the years, the Federal Reserve System has been fortunate in attracting outstanding men like Hugh Galusha -- and his successor Bruce MacLaury -- to devote their lives to public service at the central bank. The reason for this lies in the character of the Federal Reserve System and the vital role it plays in national economic policy.

The Federal Reserve was endowed by legislative mandate with a substantial degree of independence within government. Freedom from the daily pressures of the political process has given the Federal Reserve the opportunity to make the hard choices that continually confront those who are responsible for economic and financial policies. Over the years, the Congress has significantly enlarged the duties and responsibilities of the Federal Reserve System. The stature of our central bank has therefore grown within the counsels of government and in the minds of our people. Nowadays, the people of America expect the Federal Reserve to use its great powers to thwart -- or at least to moderate -- business recessions, and they also look to the Federal Reserve as the ultimate defender of the purchasing power of their currency.

To earn the confidence of the American people, the members of the Federal Reserve family have observed rules of conduct such as animate our great universities and our courts of justice. We have sought to foster a spirit of freedom and objective inquiry in the field of economic analysis. Our staff in Washington and the staffs of the individual Reserve Banks are encouraged to analyze economic and financial problems in the spirit of science and to express their findings freely. The Directors of our Reserve Banks, who are drawn from every region and practically every branch of business in our country, provide a constant stream of up-to-date information on business and financial developments. When the Presidents of the individual Reserve Banks meet with the Federal Reserve Board, as they do at very frequent intervals in our nation's capital, they have at their disposal a system of economic intelligence that cannot be matched by any organization or agency in our country or, for that matter, anywhere else in the world.

Concern for the general welfare, moral integrity, respect for tested knowledge, independence of thought -- these are the basic assets of the Federal Reserve. They are the foundation on which our nation's monetary policy is constructed.

The Federal Reserve must, of course, account for its stewardship to the Congress and to the general public. We do so through news releases, publications, public addresses, and testimony before Congressional committees. The information that our central bank discloses about its myriad activities vastly exceeds, both in promptness and detail, that of any other central bank. We do, of course, withhold for a time information that could cause embarrassment to a foreign government or that might enable the more alert members of the financial community to gain an early and unfair advantage over other citizens by becoming privy to the precise plans that the Federal Reserve has set in motion. Even here, once the need for delay in reporting has passed, full disclosure is made by the Federal Reserve, so that the Congress and the interested public may be in a position to appraise the System's policies and actions, and so that we ourselves may benefit from outside review and criticism.

It is precisely because of its openness and impartiality that the Congress has resisted occasional demands to bring the Federal Reserve under this or that administrative branch of the Federal Government. Both the Congress and the informed public have perceived the great damage that could be done to our nation's prosperity by weakening the independent voice of the Federal Reserve within our government. This sentiment, I believe, has been shared by every President since Woodrow Wilson's time, although the fervor of our presidents for the independence of the Federal Reserve may at times have been greater upon leaving office than when they themselves were still wrestling with the nation's economic problems.

Monetary policy in this country carries a heavy burden of responsibility for the maintenance of economic stability. Actually, our nation sometimes expects more from the Federal Reserve than we can reasonably expect to accomplish, in view of the imperfect tools with which we work and the complex problems that our nation faces.

During the past decade, our nation has generally experienced prosperity, but the prosperity has been marred for many of our people by persistent and rapid inflation. Many factors are responsible for this unhappy development -- among them, a protracted and unpopular war, and abuses of market power by some of our business firms and trade unions. But I believe that the most important underlying cause has been the looseness of our Federal fiscal policies. Federal spending has been rising with disconcerting speed during the past decade. Despite the costly war in Vietnam, new governmental programs have been enacted at a dizzy pace, almost without regard to their cost or to the state of public revenues.

Deficits have therefore mounted in both good years and bad. In fiscal 1965, a year of rapidly advancing prosperity, the Federal deficit came to $1.6 billion. In fiscal 1973, a similarly prosperous year, the deficit amounted to $14.4 billion. In three of the past six years, the deficit came close to -- or actually reached -- $25 billion. Nor do even these figures tell the full story of how much Federal money has been paid out to the public beyond what the government collected in taxes. Governmentally-sponsored corporations, such as the Federal National Mortgage Association and the Federal Home Loan Banks, have also gone heavily into debt and poured out additional billions that are excluded from the budgetary totals. In the fiscal year just ended, the net borrowing by Federally-sponsored agencies exceeded $11 billion.

The continuance of large Federal deficits at a time of rapid resurgence of the economy has inevitably stimulated private spending and aggravated upward pressures on the level of prices. In fact, our economy is suffering at present from stronger inflationary pressures than at any time since the outbreak of the Korean War. Prices have risen sharply since the beginning of this year, and they are continuing to rise.

In view of the huge expansion in production and employment that we have experienced during the past year, it would have been difficult to avoid an appreciable upward movement of the price level even with a balanced Federal budget. But as the Fates would have it, several unusual factors combined to impart a new dimension to our inflationary problem this year. First, the devaluation of the dollar not only resulted in higher prices of imported goods; it also affected our price level by leading to some substitution of domestic for foreign products and by imparting a sharp impetus to foreign demand for our products. Second, our economic expansion has been accompanied by rapid expansion in virtually every other industrial country. The world-wide demand for capital equipment and industrial materials -- goods for which the United States is a major supplier -- has therefore burgeoned. Third, our current ability to expand output of basic industrial materials is narrowly limited -- in large part because investment by producers of key materials has been held back in recent years by unsatisfactory profits and new environmental controls. Fourth, bad weather in a number of countries severely restricted agricultural production last year -- at the very time when the demand for foodstuffs was rising rapidly in response to the world-wide expansion of incomes and employment. The concatenation of these special factors has played a decisive role in driving up prices this year.

The inflationary problem we are dealing with today is therefore quite complex, and we must be prepared for a further rise in prices in the months ahead. The resulting damage can be minimized, however, if aggregate monetary demand is restrained. The inflationary forces that now plague us will then have a better chance to burn themselves out.

The Federal Reserve is pursuing a course of monetary policy that is designed to minimize the threat of excess demand by restricting the growth of the monetary and credit aggregates. Monetary policy began to move in this direction in the spring of 1972, but at a pace that may appear in retrospect to have been too gradual. In any event, restrictive actions have multiplied both in frequency and impact in recent months. By now, even skeptics in the financial community should be convinced that the Federal Reserve will not flinch in its determination to moderate substantially the pace at which money and credit supplies have been expanding.

A restrictive monetary policy cannot be carried out without causing difficulty for some business firms or households that seek additional credit. The homebuilding industry, in particular, is very sensitive to the level of interest rates and the availability of mortgage money. In view of the outflow of funds from thrift institutions into higher yielding market instruments, mortgage commitments have been diminishing and this is bound to affect homebuilding adversely in the months immediately ahead.

Early in 1970, anticipating precisely the kind of development that is now under way in the housing field, the Federal Reserve Board undertook a comprehensive study of the ways in which the chronic fluctuations of housing construction may best be moderated. Two years later, in March 1972, the Board presented its report to the Congress. The Board's recommendations for legislative action deserve more careful consideration than they have yet received. If the needed reforms come too late to help in the present difficulty, they can still serve the larger purpose of stabilizing housing finance over the long future. Meanwhile, the several housing agencies, which have been softening the impact of credit shortages on homebuilding activity, are in a position to continue to do so. And the Federal Reserve System, as the lender of last resort, will, of course, honor its obligation to provide emergency credit in the event of need. I might add that it appears unlikely that such a need will arise.

The time will surely come when monetary policy can again be less restrictive, but that time has not yet arrived. At present, there is no real alternative to a restrictive monetary policy. To be sure, if we permitted money and credit to expand at a more rapid pace, short-term interest rates would decline for a brief period. But in so doing we would be adding fuel to the inflationary fires now raging. Before very long, interest rates would rise again, and probably well beyond their present level, as both lenders and borrowers adjusted to the quickened pace of inflation. The simple and inescapable truth is that inflation and high nominal interest rates go together.

The Federal Reserve must therefore persevere in its present policy. Fortunately, there are some signs that our efforts are bearing fruit. For example, the narrowly defined money supply -- that is, currency plus demand deposits -- grew at an annual rate of 6 per cent during the first half of 1973, compared with a growth rate of 7-1/2 per cent during 1972. In recent weeks, the growth rate has slowed further. During July and August, the money stock rose at an annual rate of only about 2 per cent. These signs of better control over the growth of the money supply are encouraging, but the Federal Reserve will need more convincing evidence on moderation of the monetary and credit aggregates before it can responsibly relax its pressure on the monetary brake.

Of late, there have also been encouraging developments with respect to our international balance of payments. Our competitive position in world markets has dramatically improved over the past year, and the deficit in our trade accounts that was for some time a source of great concern has now all but vanished. In fact, we enjoyed a modest trade surplus in the month of July, and the outlook for our exports continues to be very promising. These developments have not gone unnoticed in the financial world, and the dollar has strengthened markedly in recent weeks in foreign exchange markets. Intervention in these markets by the Federal Reserve has helped to bring about this turn in the dollar's value. However, a more basic factor in the recent improvement in the value of the dollar relative to other currencies is the increasing recognition abroad that the American people are determined to bring inflation under control and that they will support any reasonable policy that promotes this objective.

Governmental efforts to stabilize the general price level must therefore persist until the forces of inflation are fully dissipated. Since direct controls over wages and prices in the present environment can provide only limited benefits, primary reliance in this struggle must be placed on monetary and fiscal policies.

Clearly, monetary policy must play a major role in the fight against inflation, but we should not expose the economy to unnecessary risks by overburdening this tool of policy. Additional restraint through fiscal policy, in the form of reduced government spending or increased taxes, would be helpful even now. Particularly appropriate would be fiscal measures that could be quickly reversed if economic activity began to weaken, as sometimes happens after a prolonged period of economic expansion.

We also need to improve our instruments of monetary policy to gain better control over the monetary aggregates. More precise management of money and credit supplies could be achieved if the reserve requirements that apply to demand deposits of Federal Reserve member banks were extended to all commercial banks.

The present limitation of the reserve requirements imposed by the Federal Reserve to the System's member banks, apart from being inequitable, weakens monetary control. All demand deposits are a part of the nation's money supply, and they should be treated equally from the standpoint of reserve requirements. The difficulties already imposed on monetary policy as a result of the unequal treatment of demand deposits at member and nonmember banks will become more acute in the years ahead in the absence of corrective legislation. The Federal Reserve Board must therefore urge the Congress to give this problem its earnest consideration. The solution that we shall propose will not infringe in any significant way on our dual banking system, and yet it will enable the monetary authority to achieve more precise control over the monetary aggregates.

I need hardly say, in closing my remarks, that there is much unfinished business to attend to in our struggle to control inflation, to manage the nation's money supply, to stabilize housing construction, and to deal with a host of other economic and financial problems. I am optimistic, however, about the future of our nation's economy. Progress in moving toward equilibrium in our international payments accounts has been encouraging. So also has the recent evidence of moderation in the growth of monetary aggregates. And agricultural production in this region of our nation and elsewhere is now on the increase, offering hope that food supplies will soon be more plentiful.

The principal source of my optimism, however, lies not in these general indicators of progress in dealing with economic and financial problems, but in my faith in our nation and its good people. Our country has been blessed with rich natural resources and our people have been endowed with the vision and energy to strive for a better life. Let us dedicate the new Federal Reserve building today to the brighter future that is the hope and dream of every American.

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