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Summary of Remarks

by

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Summary of Remarks
on
THE ROLE OF THE FEDERAL RESERVE SYSTEM IN A CHANGING ECONOMY

Federal Reserve policy is not the result of abrupt or arbitrary actions. The general monetary policy for which the Federal Reserve is responsible is featured by flexibility. It shifts with the ebb and flow of the economic tides. Just as businessmen seek to determine business trends by observing the signs and portents that have been found historically to have some meaning, so monetary authorities appraise business tendencies by the same signs and act accordingly.

The problem of judging the state of business is two-fold. One is the time-lag before business data become available. The other is the low visibility during certain phases of the cycle.

For monetary authorities, the most fundamental problem of timing is to perceive changes in the business climate quickly enough to take compensatory action. Promptness of action is imperative to avoid the danger of continuing a given policy after it is no longer applicable. If the authorities wait until the figures demonstrate beyond question that further credit restraint or stimulation is needed, the action may lose its effectiveness, in whole or in part. But the perils of action based on judgments in advance of confirmatory information are obvious!

Another timing difficulty stems from the integration of monetary and fiscal policy. Actions by either the Fed or the Treasury may create difficulties for the other one, however firmly these two agencies resolve to work in concert.

Monetary policy should be adapted to future contours that can be discerned only dimly and for a short distance ahead. Consequently, shifts in business outlook are rarely so definite and clear-cut that monetary authorities can decide abruptly to shift credit policy from restraint to ease,

or vice versa. Nor is a shift in policy emphasis usually decided suddenly without extended consideration. Just as a paddler guides his canoe through the ever-changing currents of a swift-flowing river, so must monetary authorities use as much foresight as possible in adapting their policies to changes in direction and condition.

Sometimes, of course, crises develop suddenly. In the spring of 1953, ebullience was high, plant expansion was rapid, inventory accumulation was large, and credit demands were strong with prospects for large Treasury borrowing ahead. The monetary authorities countered by increasing restraint on bank credit expansion. Suddenly, in a matter of days, money became so tight as to endanger the smooth conduct of business, and the restraints were eased. In retrospect, it appears that the subsequent decline in activity is to be attributed largely to curtailment of governmental defense expenditures, --a curtailment that had not been scheduled when the monetary restraints were imposed.

However, typical changes in the use of open market operations, changes in discount rate and reserve requirements evolve gradually from a whole sequence of developments in manufacturing, in commerce, in finance, and in the markets of the world. A striking example happened in the middle of 1956 when the Minneapolis and San Francisco Banks used discount rates different from the rest of the Reserve Banks. The commercial banks in those districts were experiencing such loan demand as to cause them to borrow heavily from their respective Federal Reserve Banks. The Federal Reserve directors of those two districts felt that the business sentiment reflected by this loan demand was sufficiently exuberant to require curbing. Accordingly,

they decided to increase their discount rates, subject to review and determination by the Federal Reserve Board. The Federal Reserve Board, likewise, was watching with concern the expansionist tendencies of that period, and it approved the changes in these two districts even though the other ten districts did not all follow suit for over four months.

If the value of money is to be stable and to assist the economy to move steadily upward, its supply must be harmonized with the flow of goods. The impact of the general money supply upon the economy is so great as to make it of prime concern to citizens generally. Thus, the supervision and control by government is required not only to make available sufficient money to make possible economic growth, but also to avoid making available so much as to cause inflation. As far as the total supply of money and credit is concerned, we have a managed currency. The apportionment of this supply among individual borrowers, however, is not primarily a matter for Government but for private lenders. The selection of the particular customer to whom loans are to be made is and should be left to the discretion of commercial institutions. Only if the allocation is the result of the operation of a free market will it be as impersonal as is desirable. When the Government intervenes in this market allocation to take care of especially sheltered groups through subsidies, guarantees, or direct loans, it is increasing the difficulties of those not so sheltered. Under the free enterprise system it is axiomatic that not all groups can be protected by such special shelters.

To minimize Government control over credit allocation is not to deny the essential role of Government in providing services or relief for

distress situations that cannot be appropriately supplied through the market by private enterprise or in regulating unsound credit or other business practices. These governmental activities inevitably affect the allocation of resources. The points I wish to make are two-fold: (1) Governmental measures that influence the uses of credit should be kept to a minimum consistent with its traditional responsibilities; and (2) Government funds, whether by direct payments or by extension of credit, used to promote or subsidize particular activities should ordinarily be raised as much as possible through taxation rather than through borrowing. Any deficits, that might be necessary, should be financed in a manner that is consistent with monetary policies aimed at sustained economic growth.