

RELATIONS OF MONETARY AND FISCAL POLICY TO AGRICULTURAL CHANGES

Remarks by Chas. N. Shepardson, Member, Board of Governors of the Federal Reserve System, at the Southern Farm and Ranch Institute, Houston, Texas, on November 10, 1959.

My subject this morning is listed as "Relations of Monetary and Fiscal Policy to Agricultural Changes." This sounds as if I were going to deal with technical aspects of the Government's financial management. I would dispel this threat by translating our subject into clearer and more concrete terms. Within the framework of the general subject of this conference, I think it translates itself into the problem of economic growth for the United States and into the question of how the highest rate of growth can be achieved and maintained in agriculture and in our total economy.

Economic growth for the United States is something which I assume that all of us favor whether we be farmers, teachers, businessmen, bankers, or Government employees, and regardless of the varying views we may have on Government expenditures or on how the country's finances should be run. Proceeding from this assumption, I would like to discuss some facets of the impact of monetary and fiscal policies on the attainment of the maximum rate of economic growth.

Under the Employment Act, passed by Congress in 1946, the Federal Reserve, along with all other agencies of Government, has the duty of helping to create and maintain conditions which will afford useful employment opportunities to all of those able and willing to work, and the duty of helping to promote maximum production and purchasing power. Attainment of

these conditions will result in the largest sustainable economic growth that we can hope to achieve.

A specific responsibility of the Federal Reserve is to regulate the money supply in such a way as to assist in maintaining a relative stability of the over-all price level since the money supply and prices have proved to be closely related. This over-all stability of prices is essential to providing equity and social justice for everyone who receives or holds money, or claims on money. In addition, reasonable stability of the price level is essential to adequate saving and investment, a vital prerequisite to sustained economic growth. This is a most important relationship which I shall discuss further. Let me pause to say, however, that notwithstanding the views of some individuals these two objectives of growth and stability are not contradictory nor are we faced with a choice of one or the other. Instead, relative over-all price stability is as essential to long-run sustainable growth as was a solid foundation for the erection of the San Jacinto monument.

A maximum rate of economic growth for our national economy should include a rising standard of living through increased per capita consumption. This requires rising output per worker -- that is, higher productivity -- and this in turn is brought about primarily through advancing technology and the substitution of capital investment for human labor. Hence, one essential for sustained economic growth is the maintenance of an adequate volume of real saving and investment. There must be enough savings to support the continuous renewal, improvement, and expansion of this country's total capital resources. The maintenance of such an adequate

amount of saving and investment depends, in turn, upon a broadly based and justified confidence in a reasonably stable value for the dollar.

The very nature of economic growth involves change -- changes in methods of doing things and changes in relationships. This is true in all fields of economic activity and it is especially true in such a dynamic field as modern agriculture. It is probably obvious to all of us that growth occurs whenever more efficient methods take the place of less efficient ones so that the output becomes greater in relation to the supplies of labor, materials and capital used.

What may be less obvious is the fact that increased productivity in any segment of our economy automatically confronts us with two alternative courses of action. Either we divert some of our basic inputs, including labor, to other uses in order to maintain a level of production consistent with existing demand or we attempt to broaden demand in order to absorb the increased production. One of the most effective means of broadening demand is by lowering prices, thus bringing the item concerned within the purchasing power of a broader segment of our population.

In this connection, let us look for a moment at what might be a more appropriate allocation of the fruits of productivity. At the present time there is a widely accepted view that labor is entitled to a major share, if not all, of these fruits. In fact, the claim is frequently made that as long as wage demands do not exceed productivity gains they should present no problem.

I submit that there are two other legitimate claimants. First, new technology requires new capital investment and the saver who provides

this capital must receive a share sufficient to induce the investment else he will not provide the funds necessary to provide the tools of improved technology. Second, much of the education and research back of our technology is publicly supported and on this basis alone, if not on others, the public is entitled to a share of the fruits which can best be reflected through some price adjustments in the cost of the product. Furthermore, labor itself is benefited by the broadened outlet for its products through some price adjustment, for without such increased outlet it is faced either with the task of moving and retraining for other employment or with a certain measure of technological unemployment.

Unfortunately for agriculture, the elasticity of demand for pounds of food in a relatively well-fed nation is limited. (Parenthetically, I might say that this relative inelasticity does not apply in the same degree to fiber as it does to food.) In total, however, increased productivity has enabled us to meet our agricultural needs with fewer people. As a result, some of the farm labor force has been made available for nonfarming operations. This is plainly troublesome to those who are displaced and have to find new sources of livelihood but as soon as they have become productively employed in other activities, this, too, becomes a real part of national economic growth. Changing to the production of commodities for which there is more elasticity of demand is also a part of the contribution of agriculture to the national growth process. These changes involve, in each case, a combination of new investment with new ways of making better use of labor and the other factors of production and their effect is reflected in the vast improvements that we have all seen in the conditions of American rural life.

We may now consider the influence of Governmental policies upon economic growth. But, first, let me restate briefly the two related aspects of the growth process. First, growth involves expanding the country's capacity to produce goods and services. Second, it involves the expanding of our demands for goods and services at a rate that will be just sufficient, if possible, to use our expanded productive capacity.

The first of these aspects of growth -- an expanding output potential -- depends on such basic factors as additions to the labor force, combined with advancing technology, and backed up by a flow of savings and the ability of producers to use them in constructing and developing modern plant and equipment. It also depends upon a desire on the part of the producers to do this in the expectation of being able to earn a fair return on such investments. The other aspect of growth depends upon a balanced expansion in demands for the products. This includes demands from the various sectors of the economy, such as businesses, governments, and the demand of individuals for their own consumption.

In order for growth to be sustainable, an equilibrium between these two aspects of growth must be maintained. If total demands do not keep up with the output potential, over-all growth will slacken for the inducement to businesses to add to their productive capacity will lessen. On the other hand, if total demands tend to run ahead of the output potential, the general price level will begin to rise and this, in turn, will have an adverse impact both on the growth of demands and on the means of financing increased and improved capacity. It will also have adverse effects on the efficiency with which resources are utilized and, likewise, upon the

equity or fairness with which the products are distributed through market channels among consumers, businesses, and savers.

On the output side, technological progress and the desire to save and invest savings productively are both influenced by the monetary environment. An atmosphere of price and financial stability in general is necessary both to the incentive to save and to a continuing technological advance. Thus, through continuous efforts to safeguard the value of the dollar and to create a financial climate in which savers can have confidence in the future value of their investments, monetary policy can make a contribution to economic growth quite apart from its influence on demands for goods and services.

The over-all rate of growth throughout our history has been generally good. Our problems have come from excessive instability marked by periods of inflationary expansion which have inevitably been followed by periods of recession or actual depression. We talk a lot about the necessity of controlling inflation as an end in itself or because of its impact on those most adversely affected. As a matter of fact, however, we should be equally concerned about the possibly greater impact of the resultant downturn on economic growth. It is in the very nature of growth that different segments of our economy and different areas of our country will grow at varying rates from time to time. This is a healthy situation and allows for the adjustment of resources to technological changes with a minimum impact on the economy as a whole. However, when we get inflationary pressures that pervade the entire economy at one time, we inevitably face recessionary

periods with equally broad impact on the economy. . A major problem of both public and private policy is that of moderating this instability, primarily through controlling the excessive upswings and thus minimizing the resultant downswings with which we have to deal.

To prevent inflation requires appropriate actions not only by the Federal Reserve but also by other Governmental agencies and by those engaged in business and industry, especially those engaged in wage and price decisions. While the regulation of money and credit by the Federal Reserve is important, we should never forget that it is not the only, nor necessarily the controlling factor.

Among the fields in which financial decisions by the Federal Government are important, we may mention especially the fields of fiscal policy and debt management. An important aspect of fiscal policy is simply the matter of the relation between the Federal Government's income and its outgo. If inflation is to be successfully resisted, Government expenditures and income should be kept as nearly in balance as possible and during periods of prosperity there should be a surplus of current receipts over current expenditures. Only in this way can we expect to cut down on our tremendous national debt and on the annual carrying cost of that debt. Incidentally, that annual cost of approximately 9 billion dollars is now as great as the total Federal budget in 1940.

The debt management policies of the Government, too, should take an anti-inflationary direction whenever inflation is a danger. Debt management policies are important in view of the size of the Government debt outstanding and the importance of Government securities among the financial

assets held by all classes of institutions, businesses and individuals. Among other things, anti-inflationary policy in this field requires that the Treasury be able to issue long-term or intermediate-term securities at times when the flotation of such securities would make it possible to finance the Government's needs without adding to the supply of money or other liquid assets. At present, a very large part of the Federal Government debt is on a short-term basis and the frequent need to refinance large blocks of it makes it difficult at times to use monetary policy effectively as an anti-inflationary weapon.

Apart from these problems, which are of a more purely financial nature, there is the question of the wage-price situation. The special problem here seems to be the existence of monopolistic tendencies which enable a seller of goods or services to fix prices with little regard for competitive supply and demand factors. Such situations appear to exist in a number of important fields. This may be regarded as part of a spiral process which is stimulated when the level of demand is high. There are dangers both of wage increases in excess of increases in productivity and of price increases beyond what the traffic will bear. This is not merely a matter of inflationary price rises versus price stability. It also raises the question of how far economic growth can go in the face of the clearly disruptive effects of rises in the general price level. This is true not only as it affects our domestic economy but also as it affects our international trade position.

As a result of the present steel controversy, some people are suggesting that the wage-price field should be subject to some type of Federal

control. I suggest that we not lose sight of the fact that imposition of Government control or regulation might do harm to our free enterprise system that would outweigh any potential benefits. I would certainly hope that we would explore thoroughly the possibility that certain existing laws and regulations, and the institutional arrangements that have grown up under them, may be partially responsible for our trouble. It may be that we need less rather than more Federal control. This further emphasizes the fact that business and labor leaders have a responsibility to the general public as well as to themselves as they work out their wage and price decisions.

In addition to the importance of over-all price stability, there is another factor that also seems highly relevant and, indeed, vital. This is the requirement that there be public confidence in the prospects of continuing general price stability as distinguished from expectations or fears of inflation. Confidence may even be the most important factor in assuring the continuing flow of savings and investment that is needed. This question of confidence is importantly affected by public feelings, attitudes, and psychology, as well as by actual current financial and economic developments.

In talking with this audience about the need of an adequate flow of savings to finance the functioning and improvement of our economic system, it is not necessary to emphasize the importance of a sound and stable national financial structure to the growth of modern agriculture. Farming needs much more capital than it did in the past and most individual operators have to be concerned about the continuing availability of financial resources to meet their needs.

These increased financial requirements arise from a number of causes. First, each farm requires a larger investment in land itself. The average size of an economic farming unit, simply in number of acres, is considerably larger than it was in the past, and the increase in capital needs due to this kind of growth may be continuing further. Second, farming now requires a much larger investment in capital equipment of various kinds. Some of this equipment is often referred to as "labor-saving machinery." This might imply that it is a luxury for the farmer rather than a necessity, yet we all know that an increasing investment in equipment is needed if the farming operation is to be economically competitive under present day conditions.

Obviously, when a farmer needs to borrow money, he would prefer to borrow at low rates of interest rather than higher rates. The Federal Reserve System also has a preference for the lowest level of interest rates that can be maintained. In some circumstances, however, it seems clearly in the interest of all of us to endure the pressure of higher interest rates rather than to suffer the alternative of a general rise in prices.

Recently the demand for credit in this country has been large. Despite the talk of tight money, banks added over \$11 billion to their loans outstanding between mid-1958 and mid-1959 -- more than in any other twelve month period in our history except 1955. Mortgage recordings in July hit an all-time peak of \$3.1 billion with mortgage lending by savings banks, life insurance companies, savings and loan associations and others in record volume. Consumer installment credit was up \$4 billion in the same period, passing its pre-recession peak of \$34 billion and soaring up

to \$37.5 billion by the end of September, the latest date for which figures are available. That is hardly a picture of an economy strangled by tight money.

As in the market for any other commodity, a demand in excess of supply results in an increase in price, which, in the case of money, means interest rate. This is one of the basic elements in the allocation of our resources. In the present instance, the shortage of lendable savings has resulted, at least in part, from the preference of many people and institutions for equity investments as an inflationary hedge. This is not the classical case of too many dollars chasing too few goods. Rather, it is a typical illustration of a lack of confidence in the future value of the dollar. Any effort on the part of the Federal Reserve to increase the money supply in an attempt to hold down interest rates would only serve to push up prices and further intensify this lack of confidence. As more people become worried about the inflationary prospects, they would become less and less willing to lend their savings or their capital at going rates of interest. Such an effort has been successfully accomplished only during wartime and with the additional restraint of rationing and price controls. Even then it built up a backlog of purchasing power that resulted in the big inflationary upsurge of prices following the removal of other controls after the war.

In such a process, the ability to borrow at low rates must eventually give way to an inability to borrow at all. Meanwhile, from the viewpoint of the businessman or farmer, any savings in interest costs would be overbalanced many times by the increase in the cost of materials, labor and

equipment of all kinds. Of the total operating expenses of farmers in recent years, expenses for interest paid have averaged less than 5 per cent of the total operating costs. It is clear, therefore, even from this narrow viewpoint of the operating costs of agriculture, that since inflation would raise the cost of nearly everything a farmer buys, it would impose a burden incomparably greater than any likely differences in interest costs which might arise from steps taken to maintain the soundness of our currency. This is especially true under present conditions of agricultural surpluses which would tend to forestall any offsetting increases in the price of commodities which the farmer has to sell.

In summary, then, economic growth depends upon increased productivity, which in turn depends upon the substitution of capital for human labor. This inevitably involves changes in the allocation of labor and other resources. We should welcome and seek to facilitate such changes but only at rates that can be assimilated without crippling dislocations.

Growth also depends upon a broadened, effective per capita consumer demand for the resulting increased production. This raises the question of a more equitable and constructive distribution of the fruits of productivity.

Finally, the saving and investment essential to finance increased productivity depend upon a confidence in the future value of the dollar, which can only be attained by sound fiscal and monetary policies.