

RECENT MONETARY AND FISCAL POLICY OBJECTIVES

Remarks of

Monroe Kimbrel, First Vice President

Federal Reserve Bank of Atlanta

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I am delighted to be here today, not only because of my memories of wonderful years spent working with Rotary and other groups like you, but also to re-visit one of my favorite Georgia spots, Brunswick. Although my economists tell me that Brunswick and Glynn County have slowed down a bit in the last year or so, it is difficult to see any evidence of it. I recognize that for a community which enjoyed an annual population growth rate of 4.4 percent in the 1950's and almost 5 percent per year between 1960 and 1965, any slowing would be hard to take. However, Myd tells me that most of your major employers either continued to grow or at least held their high levels during the past year.

You know, the economic record of the past six years has no parallel in American history. Even though some substantial adjustments have had to be made in the last year, we are still in our longest period of sustained, high-level growth. After your experience with expected rapid industrial growth flowing from the Thiokol plant and the adjustments your community has had to make as a result of Thiokol's failure to land a prime contract, I know you are no stranger to adjustments. However, I also know that, though painful, these and other shortfalls were not fatal and were partially compensated for by growth in employment in your other large industrial plants and in further growth in your seafood, tourist, and other service industries.

Let me turn now to a subject which sounds awfully complicated but which must be understood if we are to appreciate the financial

developments going on all around us. As a central banker, I am primarily concerned with monetary policy and with service to our member banks, but I know that you have seen and heard frequent references to more active fiscal policy in recent months. I believe we can profitably think together about these two types of policy and their actions and interactions, which sooner or later affect our jobs, incomes, taxes, and standard of living.

Let us note first that our economic policy objectives as a nation have been more clearly defined since World War II. Many of these objectives have been incorporated into law. Others have been so often embraced by both major political parties as to be firmly established. You've heard some of them often, but the major ones bear repeating as a starting point in trying to unravel this ball of wax called "interaction of fiscal and monetary policy."

First, we strive to use our resources in such a way that job opportunities continue to expand. Second, we have to have balanced growth, so that future resources can be more fully used--in other words, so that our capital base is capable of expanding and providing for a growing population. We also have to insure that the income you receive is not whittled away by runaway price increases. With your close interest in your own port activities and in Glynco Naval Station, I know that you will fully appreciate the fourth objective--that we do not cripple ourselves internationally in economic or other areas, so that our capacity as leaders of the free world is impaired.

This modern economy of ours is a huge and intricate thing-- and so is the role of the Federal government in it. For example, the Federal government owns 34 percent of the land in this country, buys 23 percent of what is produced, contracts for 30 percent of all construction, generates 25 percent of the electrical power, and hires about a fourth of the workers. Like it or not, the impact of this public sector--not to mention that of state and local government--is enormous. Mistaken action or lack of action in either the monetary or fiscal policy areas can cause or accentuate disturbances which can result in sharp changes in an economy which operates at a vastly accelerated pace over that of 20 years ago. Let me illustrate a few of the main tools of monetary and fiscal action.

Not long ago I flew to San Francisco in one of our modern jets and was impressed with the analogy between this flight and our modern economy. You know, it hasn't been so very long ago that most of our airplanes were small, slow, and low-powered. Many of them would virtually fly themselves once you got them up and provided you steered clear of heavy weather. Flying then and now, however, had one essential element in common--you depended primarily upon the continued operation of a vital system of power production and transmission to keep the airplane moving forward--and to keep it up! I like to think of this as comparable to our private market system and its intricately varied forces. We still have to depend on this private sector for the basic power and the underlying thrust of our economy.

In our modern world, just as in the old days of relaxed and less complicated flying, the aircraft requires a pilot and a crew to utilize this forward thrust in purposeful ways. The businessman, the consumer, the banker, the saver, and a host of private individuals share in this direction. However, whether one likes it or not, government and its agencies have always had something to do with the utilization of this private power system. True, there have been times when such influence was exerted by deliberate non-action; at other time in our longer history, non-action was the product of ignorance of the proper measures to be taken. At still other times, well-meaning but human individuals took the wrong action or took it at the wrong time.

Be that as it may, we are now living in a jet age, not only in flying but also in our high-output, high consumption, and high-investment economy. In both cases we have much more knowledge, many more aids, and more experience in utilizing them so as to avoid or minimize the occasions or the extent to which the "ship" gets beyond its stability limits and ends up in catastrophe. In either case, balance and stability are much more readily retained if small but timely corrections are made.

Let me develop this analogy a bit further in order to illustrate the roles of monetary policy and fiscal policy and their inter-relationships. On my jet flight to San Francisco I noticed that from the moment of buying my ticket to getting off the ship, there were numerous aids, procedures, and devices that reminded me of the

pervading influence of particular types of fiscal policy. Consider a few of these in this light--for example, the servicing of the aircraft might usefully be compared to the annual budget and the changes that are sometimes required in it. The amount of jet fuel, food, oxygen, and other necessary supplies had to be keyed to the mixed passenger-airfreight load, expected flying conditions, route, and so on.

In planning the "payload" the amount of fuel, like the total of savings, investment, and taxes, must be enough but not too much. If not enough, the objective would not be reached even though more passengers or freight could be initially loaded. If there were too much fuel, then the excess carried would cut down on speed, safety, or the volume of payload. At each stop, this same process of planning fiscal policy in advance and in context with expected flows of savings and investment would have to be repeated; and if on the first leg of the flight too many taxes had been levied--too much fuel loaded in the tanks--then adjustment could be made on the next leg. But meanwhile the loss in payload, speed, or other sacrifices caused by carrying the extra fuel--taxes--could not be recouped.

This part of the analogy can be applied to the kinds of adjustments in fiscal policy which we saw in the 1960-mid-1965 period. Changes not only in amount but also in the impact of these taxes were made from time to time to enhance the capacity of the private sector of our economy to achieve maximum performance. I believe you will agree with me that, through such major shifts in tax pol-

icies as the investment tax credit, liberalized depreciation provisions, reductions in personal taxes, and other changes, the private sector of our economy was freed to perform at a more effective level during this period.

Once we were airborne, I noticed still other features of my flight that reminded me of monetary policy as a means which the pilot could use to maximize his achievement. His supply of fuel, comparable to savings, profits, private investment plans, governmental budgets, and consumer spending, flowed through an intricate fuel allocation system, which we may think of as the family of banking, other financial institutions, and the money and capital markets. Fuel from these many tanks flowed through a connecting system activated by the commercial banking system. The throttles controlling this flow may be compared with the various means of executing some forms of monetary policy. Let me give you an example.

At one point I noticed that the aircraft appeared to be loafing along and slowly losing altitude. Pushing on all four throttles, the pilot injected some additional fuel into the power system, just as we in the Federal Reserve System would do through open market operations. That is, by buying some Treasury securities in the open market or by supplying some funds to Government securities dealers through repurchase agreements, we supply additional dollars to the economy. The connection through which they are supplied is a build-up of reserves in the commercial banking system. In this case, neither we nor the pilot may be absolutely sure from which tank--

savings, investment, government or consumer spending, profits, etc. --the temporary shortfall of fuel originated. Nor do we try to distinguish which engine will get how much of the additional fuel, although the commercial banking system, just like the fuel sub-system on the aircraft, can be relied upon to distribute and utilize it. I might add here that we in the Federal Reserve System did a great deal of this during the 1960-65 period, working with expansive fiscal policy, to stimulate growth toward full employment.

At still another point in our flight, the pilot came on the intercom and announced that he had received clearance to change altitude from 30,000 feet to 35,000 feet. Because of changed weather conditions, wind velocities, and other traffic, this departure from our original plan now offered better efficiency, speed, and other conditions. To make the climb, however, the rate of fuel consumption would have to be increased temporarily, after which it would be less than before. In making the decision to accept this change, the crew went through a similar process that the Board of Governors might do in deciding to reduce the reserve requirements of our member banks. In short, the composite needs of the economy and the changed external conditions might justify lowering reserve requirements of our commercial banks in order for the economy to operate on a more efficient level. One more point in this analogy: The changed conditions could have been met, and a new level of operations reached, by other means. For example, the pilot could have declined to make the change, waiting and hoping for a reversal of

the conditions; or some of the payload (spending goals) could have been jettisoned--always a dangerous operation--and the new altitude might have been achieved at the same fuel consumption rate.

Throughout the flight I noticed that the crew had a variety of means of maintaining the speed, stability, and direction of the aircraft. At one time we nosed down slightly and began gaining speed; almost immediately stabilizers (comparable here to some automatic fiscal stabilizers, such as social security, unemployment benefits, graduated income taxes, and a number of others) were quickly brought to bear and helped us back to our original path. The same thing happened when we started to nose up and were trying to climb at too great a rate, except that in this case the pilot also had to help a bit because one of the control devices didn't respond quickly enough. I want to emphasize here that these so-called automatic stabilizing fiscal policy measures, having become permanent additions to our tool kit, cannot always do the entire job. Once the economy has moved decisively up or down from a particular path, it may require quite sizable doses of fiscal or monetary policy, or a combination of both to help it back on course.

Going over New Orleans, I noticed that one engine on our aircraft seemed to be overheating. The pilot made a few selective adjustments, including cutting back on the throttle on this particular engine--much as we do in raising margin requirements if stock market speculation should begin to get out of hand. We have done this and have taken other selective monetary measures in the past, but

except in emergency situations we prefer to operate through general monetary controls.

A bit further along toward Dallas, I learned from the flight engineer that, due to some sort of temporary pressures, a great deal of fuel was being dumped from one of the tanks, affecting the balance of the aircraft. Since this was in late August last year, I immediately thought about the rapidly developing tendency of our commercial banks to sell off municipal and other securities in a badly depressed market to secure funds for further business lending. I don't know how the flight engineer righted this situation in his case, but in our case, selective monetary policy was again brought to bear. Changes in discount policies were made, which enabled banks under pressure to arrange for loans with us for longer than usual periods, provided they brought their business lending under tighter control. This enabled them to secure needed reserves without dumping Government and municipal securities onto a badly depressed market.

We were clipping along about 600 miles an hour between Dallas and San Francisco when I felt myself pulled forward against my seat belt as the airplane began to slow. We were entering turbulence and slowing to avoid compounding it, thereby reducing the risk of losing a wing, just as our economy had to slow down last fall when we approached greater imbalance. It wasn't enough for the pilot to reduce the fuel supply further (comparable to tighter monetary policy); he had to bring into play some optional controls which changed the flying characteristics of the plane itself. As he applied the air

brakes, lowered the flaps a trifle to increase the lift at lower speeds, and made other timely adjustments, I couldn't help thinking that our economy at that time needed some additional slowing from fiscal policy. We did get it, in September, as you recall--President Johnson and the Congress used the fiscal air brakes in the form of suspension of the investment tax credits and action to redirect and increase the flow of money into the home mortgage field. These actions, together with some independent decisions by consumers in slowing down their buying and increasing their savings, resulted in considerable slowing of the economy.

In a jet aircraft just as in our high performance economy, it is sometimes desirable to reduce speed and come down to lower altitudes rather rapidly. This is the most tricky maneuver of all --to accomplish a slowdown without overdoing it. As we approached San Francisco on instruments in a thick overcast, it was necessary to come down from 25,000 feet to 20,000 feet in a small airspace and at the same time not build up enough speed to overshoot the ground control approach pattern or to overstrain the aircraft. Our pilot warned us over the speaker that after cutting back on fuel (monetary policy), he was going to apply a rather heavy dose of fiscal policy by reversing the thrust on the two inboard engines. Then he increased the power once more on the two outboard engines and nosed down, at the same time using some flaps and increasing the power on the two inboard engines as powerful but controllable airbrakes. Using this combination of controls, comparable to a mix

of fiscal and monetary policies, he was able to get to the lower altitude and somewhat lower speed very quickly. At the same time, however, he could reverse or check the maneuver at any point. We in central banking and the current administration at the Federal level are now engaging in a somewhat comparable effort to assist the economy to recover from the imbalances of 1966, adjust to a somewhat lower pace of activity, and at the same time maintain enough flying speed and stability to avoid too much slowdown.

Now that we are back on the ground--and I hope nobody is airsick--let me just summarize the main fiscal and monetary policy tools:

Monetary policy operates through increasing or reducing the supply of money and credit to the economy. For the most part it leaves the distribution or channeling of this money to the mechanisms and decisions of the private market place. It operates through the financial markets and commercial banking system and depends upon a rationing mechanism familiar to you as interest rates.

Fiscal policy operates through changing the levels of spending by government, and by changes in tax policies which produce the revenues to support varying levels of spending.

I have already alluded to many of the specific policy actions most commonly used. Now for a final word about what we are trying to do. Since the latter part of last November it has become increasingly clear that the combination of monetary and fiscal policies then in effect had become more restrictive. This was so because the private sector itself had in the meantime slowed down. Since that time, monetary policy has moved to a considerably less restrictive stance in a succession of moves, the latest of which was the

recent reduction in reserve requirements on most forms of savings and time deposits. We have also supplied reserves to the banks in other ways.

Fiscal policy has also become less restrictive, and for the same reasons--the pressure on total resources has abated considerably, primarily in the slowing of business investment plans but also in a reduction of consumer buying. Restoration of the 7-percent investment tax credit, now being considered in Congress, is a prime example of less restrictive fiscal policies. So are the recent moves to stimulate greater availability of credit in the housing industry through aid to specialized institutions devoted to that industry.

We hope, and we now believe, that we have successfully applied a mixture of monetary and fiscal policies to an over-heating, over-speeding economy which needed to come down rather quickly to a lower level. Of course, we will have to leave it for historical appraisal, whether or not we have been entirely successful or whether exactly the right tools were used at the right time. We have worked out these changes with full appreciation that the basic power of our economy comes from the private sector.

One other point is worth keeping in mind: the onward movement of our economy and the quest of the goals I outlined earlier, are quite different from the admittedly oversimplified analogy of the jet flight which I have used. In our economy we don't land and park the ship--it moves from one set of difficult interrelation-

ships, sometimes before they are fully known, to another set which is never the same. Moreover, where the pilot and crew of the jet have clearly defined symptoms of developing difficulties, it is not always easy to spot or appraise them in our economy. Finally, the jet crew has a captain who does not have quite as many occasions of conflicting goals, in which actions have to be taken with the knowledge that a compromise or trade-off between conflicting goals may be the best you can get.