Kiwanis Club
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Walking the Tightrope

It has not been so many months since I was last in Columbus, but even so, the signs of change - of growth and progress - are remarkable. And, of course, the end is nowhere in sight. The new midtown shopping center will change the face of the city, as will the new hospital and mental health clinic to be built in Bradley Center. The two big new motels planned for the bypass in Phenix City represent a considerable investment in the growth of the area.

We try to keep up as well as possible with developments in our District and, while I don't want to bore you with statistics, a few will confirm in cold figures the impression one gets from a visit. For example, from 1960 to 1967, population increased nearly 20 percent. From 1962 to 1966, payroll employment in the metropolitan area increased by nearly 18 percent, and the unemployment rate went down from 5.7 percent to 3.5 percent. Retail sales in the same period went up by 33 percent, as the increased employment, as well as higher wages, made possible increased consumer spending.

Your banking community participated in this growth and helped to make it possible. Deposits at member banks rose 72 percent from June 1962 to June 1967, and loans increased by an impressive 105 percent.

Thus, over the past 5 years, the Columbus area has shared with the rest of the country an almost unprecedented growth in output, employment, and income. We all want this growth to continue, because it means increasing prosperity for ourselves and increasing opportunities for our children. Which brings me to the theme that I want to establish ~~this~~ today ~~evening~~: our collective responsibility for maintaining stable economic growth. We all--the business community, labor, government and the financial community--have large stakes in the maintenance of growth with stability. No one wants to return to the depressed conditions of the thirties nor to the inflation of the years right after World War II. But opportunity carries with it responsibility. The Federal Reserve System bears a large share, but by no means all, of this responsibility.

The Act which established the Federal Reserve System said that the System's purposes were to provide an (1) elastic currency, (2) provide facilities for discounting commercial paper, and (3) improve the supervision of banking. It was recognized, even from the beginning, that these purposes, although desirable in themselves, were also means of helping to achieve the broader goals of (1) price stability, (2) high levels of employment, and (3) rising levels of income and consumption. These broader goals have come to be more and more explicitly recognized, through legislation such as the Employment Act of 1946, as the ends to be sought by total national economic policy, of which the monetary policy of the Federal Reserve System is a part.

The Federal Reserve System makes its influence felt by affecting the amount of reserves available to member banks. The more reserves the banks have available, the more loans and investments they can make, thus increasing the buying power available to business, consumers, and government. The less the reserve availability, the less credit banks can extend. At any given meeting of the Open Market Committee, policy makers have to decide which of these courses to follow. But this is not always an easy task.

If millions of people are out of work, prices are falling, and production is declining, there is no question of which direction monetary policy should move: obviously the System should supply reserves to the banks and do everything in its power to encourage credit expansion so as to put idle resources to work. If, on the other hand, prices are rising rapidly, job vacancies are increasing, and production bottlenecks are widespread, the obvious course is to restrict the growth of bank credit, perhaps, in extreme cases, even to reduce total reserves. At either extreme, there is no problem for policy makers. It is, paradoxically, when the economy is behaving best that the policy maker's job is most difficult. Any airplane pilot knows that it takes more skill to maintain a given course and altitude in the face of variable winds than it does to get there in the first place. And unfortunately, no automatic pilot has yet been invented to guide the economy safely on its course.

Just as the pilot must anticipate storms that might blow him off course and prepare to make the necessary changes, so the monetary policy maker must be able to foresee the disturbances the economy is likely to face in the near future, because there is always some lag between action and response. And economic forecasting, in spite of all the advances in computer techniques, is still even less exact a science than weather forecasting.

Still, the record of the last six years is, we believe, pretty good. From early 1961 to the middle of 1966 the Federal Reserve System supplied increasing amounts of reserves to its member banks, chiefly through open market operations. As a result, all during the period there was a consistent rise in bank credit. This additional credit supplemented the saving of consumers and businesses. It helped to put men and resources to work and added to our productive capacity. The unemployment rate fell markedly from the high levels of the 1960-61 recession, factory operations moved nearer capacity, and at least until 1965, prices remained remarkably stable. This was what we wanted-stable economic growth without inflation.

By the latter half of 1965, however, it became apparent that inflationary pressures were building up. The unemployment rate was rapidly approaching the 4 percent rate that the Administration had set as a target;

factories were getting very close to capacity utilization; and, as a result, prices were rising too rapidly for comfort. In particular, wholesale prices, which had been almost unchanged since 1958, rose about 4 percent in a year. Although production continued to increase, demand for goods was increasing even faster and was outrunning the economy's productive capacity. In these circumstances, the Federal Reserve had to make a decision. It could continue to supply additional reserves in sufficient quantities to permit the banks to satisfy all their loan applications at unchanged interest rates-and, of course, there are always pressures to keep the credit tap open. No one likes to stop a good thing, and inflation always gives the illusion of prosperity. People see their incomes increasing and businesses see their sales going up, and they may not realize immediately that they can't buy any more with the extra money because everything costs that much more.

On the other hand, the System could restrict the amount of reserves available to the banks. This would tend to hold down the growth of purchasing power and thus restrain the rise in prices, but it would also mean a rise in interest rates, as borrowers competed for the available loan funds. It would, incidentally, also make it more difficult and expensive for the Treasury to finance the Federal deficit, inflated because of the war in Viet Nam.

The Federal Reserve chose the policy that seemed necessary in the circumstances, although it was perhaps not the most popular one. In December of 1965, the System raised the discount rate from 4 to 4½ percent. This action was designed to make it more expensive for banks to borrow from the System in order to expand their loans. Twice during 1966, reserve requirements against time deposits were raised. Open market operations supplied less additional reserves to the banks than they would have liked, although, until the second half of the year, total reserves actually continued to increase.

In the meantime, the Federal Government had also contributed to slowing down the inflationary spiral through such actions as putting corporate tax payments on a pay-as-you-go basis sooner than originally planned, reinstating the excise taxes on automobiles and telephone charges that were dropped at the beginning of 1966, reducing the under-withholding of personal income tax, and reducing non-defense expenditures. Unfortunately, the tax programs did not have their full effect until after a considerable time lag and so, until September of last year, nearly all the strain of holding inflation in check had to be borne by Federal Reserve monetary policy. As a result, interest rates rose to record postwar levels and banks found themselves caught in the tightest liquidity squeeze in many years. In September, President Johnson asked Congress to suspend temporarily the 7 percent tax credit on investment in machinery and equipment and the accelerated depreciation provisions on new buildings, and announced that the government would take whatever steps were necessary to combat inflation.

These fiscal measures, taken together with monetary restraint, produced the desired result. The price rise was moderated, the formerly feverish pace of inventory acculumation slowed down, and in 1967, industrial production actually declined slightly. As soon as it became evident that the boom had cooled off, the Federal Reserve reversed its policy of restraint and began once more to supply additional reserves to the banking system. It was just as important to prevent a recession in economic activity as it was to prevent the former inflationary excesses. The latest figures seem to show that this, too, has been successfully achieved. Bank loans have resumed their upward climb and industrial production, employment, and retail sales have all turned up. Gross national product, which actually declined in the first quarter of this year after making allowance for price rises, rose a healthy $4 billion in the second quarter.

But-worryingly-prices seem perhaps to be on the rise once more. And there are enough indications of potential inflationary pressures to ensure a continuing plentiful supply of gray hairs for monetary policy makers. Viet Nam is a constant drain that has repeatedly upset the calculations and the best intentions of the Federal budget makers. Long term interest rates, after falling in late 1966 and early 1967, are now higher than they were a year ago, indicating a strong demand by business for funds for expansion. Can the growing productive capacity of the economy keep pace with the demands - both military and civilian - being put upon it? This is the question that is most likely to absorb the attention of Federal Reserve policy makers in the months to come.

On the other hand, if all our best hopes are realized, and a halt can be brought to the fighting in Viet Nam, this will create problems of readjustment. Columbus businessmen must be acutely conscious of the difficulties that Columbus would face if the world situation would allow us to reduce significantly the size of our military establishment. We must all have, at the least, contingency plans to handle a period of reconversion.

It seems to me there are two principal lessons to be learned from the experience of the last two years. One is that economic policy must be flexible. We must be prepared to counteract inflation, as in 1965, and to reverse that policy, as in 1966, soon enough to prevent the necessary cooling off period from developing into a recession. This flexibility is absolutely essential and, because tax changes by the Federal government inevitably require a good deal of time for congressional consideration, the monetary controls of the Federal Reserve System - and its freedom of action - are vitally necessary weapons.

The other is that the Federal Reserve System cannot do the job alone. It must work cooperatively with Federal policies on taxes and expenditures, so that they reinforce one another and do not work at cross purposes. The System must also have the willing cooperation of banks, of the business community, and of labor. We all have a great stake in continued prosperity. Let us balance that opportunity with a sense of prudence and responsibility.