

MONETARY POLICY: SUCCESSES AND CHALLENGES

Remarks by

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In recent years and particularly since the late 1960's, the public's perception of the Federal Reserve and the role it plays in the economic welfare of our nation has grown enormously. Actions that we take to establish the discount rate, to influence the level and rates of growth of the money supply, to set reserve requirements for the banking system, and actions designed to stabilize the value of the dollar in foreign exchange markets make headlines almost daily.

A highly visible, first line policy-making position is not a role that has been actively sought by the Federal Reserve--as a matter of fact, visibility generally complicates our efforts to carry out our assigned responsibilities.

Why and how the Federal Reserve has come to occupy its present position may be of some interest to historians but would serve little purpose for discussion here today. However, cast against this backdrop, the recent announcement by President Carter of his selection of G. William Miller to succeed Dr. Arthur Burns as Chairman of the Federal Reserve takes on additional importance--particularly to those of you who practice the art of forecasting future economic events, including interest rate levels.

Dr. Burns is a well known and highly respected individual with a proven track record established over a long period of public service. In my judgment, the nation owes him a debt of gratitude for his persistent and often singular voice expressed in support of prudent fiscal and monetary policies. On the other hand, Mr. Miller's views with respect to monetary and fiscal matters are not well known. It is, therefore, not surprising that speculation is now taking place as to what the course of monetary policy will be under his leadership.

The press is devoting considerable attention to every aspect of Mr. Miller's activities, both past and present, and I must say that I read each of these accounts with more than a passing interest. However, my experience with successful businessmen, coupled

with the opportunity to observe first hand the dimensions of the job, leads me to be very optimistic about Mr. Miller's nomination as a strong and sensible choice to head the Federal Reserve.

Given the broad responsibilities of the System and the nature of its policy-making structure, I would not expect to see any radical departure from the flexible but steady approach to the management of monetary policy which has become characteristic of the Fed.

In addition to the nomination of Mr. Miller, the Fed has been in the news recently with regard to the actions taken to counter the disorderly conditions in the foreign exchange markets that have affected the value of the dollar internationally. The Fed's actions have included official intervention on behalf of the dollar as well as an increase in the discount rate, which has been accompanied by a rise in most other domestic interest rates.

In view of these events and the increased interest in the Federal Reserve, I would like to discuss briefly with you the role that the Federal Reserve has played in our economy over the recent past and what we may look forward to in the period ahead.

As most of you know, Congress has set forth rather specific objectives to guide the Federal Reserve in its conduct of monetary policy. The Employment Act of 1946 provides that the Fed shall conduct policy in such a way as to achieve: (1) a fully employed economy; (2) stable prices; and (3) a reasonable balance in our international payment accounts.

Given such specific instructions, the question can reasonably be asked: how well has the Fed performed when measured against these objectives?

In the abstract, the answer to that question would have to be--not very well. Currently, unemployment is running about 6.3 per cent of our total labor force and at a time when we are using only about 83 per cent of the nation's total plant and equipment capacity. Inflation is running at a rate at or above 6 per cent and for the first time in our history we will record a \$27 billion deficit in our balance of payments accounts for 1977.

For its strongest critics, the answer to the question, "How well has the Fed performed?" is quite clear -- the Fed has failed. This kind of analysis adds support to the proposal that the direct responsibility for formulating the nation's monetary policy should be shifted from the Federal Reserve to either the Congress or to the Administration.

I believe this kind of analysis is much too narrow and as a result, I cannot agree with these conclusions. In my opinion, the Fed has performed remarkably well in the recent past and deserves very high marks. A proper analysis would have to take into consideration the tools available to the Fed to do the job and the circumstances and conditions under which the job is to be done. When viewed from this broader perspective, my score card would read something like this:

In the spring of 1975, this nation's economy had reached the depth of the worse recession that it had experienced since the 1930's. At the same time, all of the major developed countries of the world and our trading partners were in a similar position.

We had been hit with an energy shortage -- with a quadrupling of imported oil prices; a steady decline in the output of goods and services over a period of several quarters; historically high interest rates; an inflation rate at the double digit level; and an unemployment rate of about 9 per cent.

We also were a nation recovering from an unsettled political environment in which an unelected president was struggling with Congress to reestablish the proper checks and balances in our government, at a time when all official institutions were suspect.

Given these circumstances and the Federal Reserve's limited ability to influence the course of events by altering the amount of money and credit available to our economy, the Fed adopted a moderate policy designed to provide a monetary stimulus to the economy in an amount designed to fuel the spending and investment required to expand output

and create jobs, but which would at the same time tend to diminish the level of inflation which had contributed greatly to the recession in the first place. To accomplish these goals, the Federal Reserve has committed itself to a policy of gradual -- not abrupt -- lowering of the long-run rate of growth in the supply of money to a level consistent with the economy's potential to expand at a noninflationary pace.

In my view, the economic results of the past three years confirm the wisdom of the Federal Reserve's policy stance. The nation's economic recovery has been broad-based and it is continuing. In just three years since the recession bottomed out, 8.3 million jobs have been created in the economy. This growth is unparalleled in either absolute or percentage terms since World War II. Stated another way, it seems to me too little attention is given to how many persons are employed--presently--over 90 million--which translates to 58 per cent of every man, woman, and child over the age of 16--is gainfully employed--a record high employment level. At the same time, the money growth fostered by the Federal Reserve which has financed such a large gain in employment and national output has been limited enough to permit a marked retreat from double-digit inflation.

Moreover, inflationary expectations have been defused somewhat, as evidenced by stability or declines in long-term interest rates over the recovery period. Even short-term interest rates, despite relatively sharp upward moves in recent months, are in the general range which existed when the recovery began. Stability in financial markets has contributed to an environment in which businesses and government units could put their affairs in order in preparation for continued support of economic expansion.

The underlying strength of this recovery has been felt at various times during the last three years. For example, the so-called "economic pause" of 1976 was followed by last year's paralyzing winter and related problems. A weaker economy might have toppled from either event. But the sound fundamental underpinnings of the economy--nurtured by confidence and an appropriate level of monetary and credit fuel--were strong

enough to sustain it. We are experiencing a very solid recovery at a sustainable rate. However, I am struck by the lack of confidence that has prevailed throughout the recovery period. It must be the least enjoyed recovery on record.

Certainly most would agree that the nation has made strong progress despite the pervasive negative forces at work before and during the recession period. Our Government has survived the uncertainty accompanying the contrasting leadership styles of three Presidents within three years. Our economy has responded to reasonable policies designed to restore sound growth. A firm base has been built for further social, political, and economic development. But you also will agree, I'm certain, that a great deal of work remains to be done to insure the kind of economic stability the nation must have to fulfill its vast potential.

In retrospect, I believe it is clear that one major reason for our present economic health stems from the continuing independence of the Federal Reserve System. The central bank's independence within government has permitted the Federal Reserve to resist calls for stepped-up, overly stimulative money growth in favor of the moderate course which has now proved correct and beneficial. It is this freedom to operate objectively in the national interest, outside the arena of partisan political concerns, which we in the Federal Reserve seek to preserve. We are gratified, of course, that many in government, and others in business and finance, support this independence. We are convinced that continued objectivity is essential to the formulation of a rational monetary policy.

Viewing our national economic prospects in the short term--particularly the outlook for 1978, my own view is that the strong economic base established over the last three years of expansion will carry through 1978 and beyond. The trends and recent developments in overall national output are good, and even sector-by-sector analysis reveals no major problem areas. Demand for money and credit continues to be very

strong, indicating general confidence in business prospects. The recent downward trend in unemployment is encouraging, as is the relatively stable rate of price increases.

As we look into 1979 and beyond, our present good fortune should not cause us to be complacent, however. Rather, we should view this period of stable conditions and good economic growth as an opportunity to set in motion the kinds of forces which can help prolong the current recovery. We also should view this period of expansion and absence of crisis as an opportunity to address some difficult national problems. What better time to focus our attention on problems of energy, inflation, and unemployment than now when we have an environment which does not force intemperate, uncoordinated solutions?

To insure a prolonged recovery into 1979 and beyond, it seems to me that we must have strong leadership from the President and the Congress expressed in realistic legislative programs. For instance, I think it is essential that we have:

1. --A meaningful anti-inflation policy which incorporates control of the Federal budget--perhaps even a lid on Federal expenditures--given the inflationary impact of budget deficits and huge Government borrowings. Such a policy should feature a strong, persistent stand by national leaders against inflationary excesses.

2. --A meaningful package of energy policies which include not only programs of conservation, but actions which stimulate domestic energy production. Both steps would help reduce the nation's reliance on imported energy and help to stem the troublesome flow of dollars overseas.

3. --A creative tax policy which provides incentives for capital investments in this country by domestic as well as from foreign sources. An innovative tax policy also should include incentives for businessmen to find solutions to the nation's structural unemployment problem--that is, the unfortunate exclusion of the unskilled young, women, and minorities from full labor force participation.

These are just some of the policies which have the potential for chipping away at the fundamental problems I've noted, while at the same time extending the current economic recovery through 1979 and beyond. These also are the policies which, if put in place, could relieve the pressures on the Federal Reserve and monetary policy which too often is forced to carry a disproportionate burden of economic stabilization actions.

As observers of the business and financial scene, many of you do understand the highly influential role that monetary policy plays in our economy. Many of you may be aware of how often the Federal Reserve has appeared to stand alone against inflation and other excesses. As a result, you may have concern about the course of monetary policy this year and in the future because of the upcoming change in leadership at the Fed.

While the news media may continue to speculate about monetary policy leaning this way or that, I believe that the public should understand that a change at the helm does not necessarily imply a change in course. In my opinion, the Federal Reserve will remain committed to the policy which has proved so effective in recent years -- that policy which has promoted real economic growth while, at the same time, has acted to moderate inflation. I believe we will resist vigorously any attempts to push the Federal Reserve toward a course of excessive monetary expansion which is not in the long-run best interests of the American economy.

In summary, I believe we can look forward to 1978 as a good year for business activity--absent any unforeseen outside shock such as an oil embargo or other similar event.

I would expect to see the economy continue to expand at a rate of about 5 per cent in real terms--a further reduction in the rate of unemployment to about 6 per cent--and a rate of price inflation only marginally higher than we experienced in 1977.

For 1979 and beyond, we will have to receive some help from legislative programs

dealing with inflation, energy, and taxes to insure a continuation of this recovery at an acceptable pace.

For the Federal Reserve, I believe it will review economic events as they unfold in the period ahead and apply a monetary policy which will foster continued growth but designed to reduce the level of inflation.

I appreciate very much the opportunity to discuss these issues with you today. A wider understanding of the role of the Federal Reserve System is necessary if the Federal Reserve is to continue to provide objective leadership in the nation's economic and financial affairs.