

also - Brookings

Ins. Fed. of Minn.  
St. Paul Hilton  
October 31, 1967  
H. D. Galusha, Jr.

An Assessment of  
Current Monetary Policy(?)

What to talk about tonight has been somewhat of a poser. Until it was too late to run for cover I did not find out it was an after dinner appearance before a desegregated audience. I would think it a mixed blessing, but no more than poetic justice, for those militants who have been urging equal rights for women, that they should be given the same right to frustration and indigestion their husbands have had since the industrial ceremonial first became rooted in the American scene. But a detailed account of the state of the United States economy as it appears this fall would be cruel. Most of you are familiar with the old story about the small boy who insisted on querying his mother about the function of the carburetor instead of asking his father, because he did not want to learn as much about the carburetor as his father would tell him.

I suspect that most of you would just as soon hear less about current economic policy--and why it isn't working--than I am prepared to tell you. Besides, when I left the house for this dinner, Jean, speaking for womankind generally I suppose, asked me to please make an effort to be clearer than I usually am, for those poor people have been sitting a long time. Having arrived here tonight somewhat indirectly, after touching down in Lincoln, Nebraska and New York, the appeal to my sympathy was unnecessary. And if you think this an indirect way to get to St. Paul from Deephaven, you are only partially correct. The state of the highway construction around the Twin Cities is such, this may have been the best route.

Instead of the announced topic, it seemed to me it might be mutually useful if I concentrated on a broader view of the Federal Reserve System, how it fits into our government, and then perhaps a few words about where we've been, where we are, and where we are going in an economic sense.

To start with, it is a system--not a single monolithic structure tucked away in the corner of the Finance Ministry as it is most places in the world. It is not a particularly rational framework--in fact those of our citizenry with a passion for orderliness like the planners in government and industry who delight in drawing nice neat boxes of authority connected by precise lines that always intersect with square corners, are horribly frustrated by the whole untidy business. Two in particular-- a congressman whose first initial "W" could stand for either Wright or Wrong, and an equally distinguished economist in Chicago named Milton Friedman have devoted their careers to correcting the situation.

What is this creature, anyway? Visualize if you will, a triangle with a broad base of commercial, privately owned banks at the bottom. (I might add parenthetically that this illustrates the almost infinite adaptability of the human mind. A very few years ago when I was a director of a commercial bank and wholly in the private sector, I might have put them at the top.) These banks control resources in the form of deposits that on June 30, 1967 totalled <sup>in excess of</sup> \$350 billion. All of those commercial banks holding national charters, plus those state chartered banks who voluntarily agree to do so, are stockholders of the Federal Reserve Bank of the district in which they are located. There are twelve of these. The Federal Reserve Bank of Minneapolis, the Ninth Federal Reserve District, has stockholders in the four whole states of Montana, North and South Dakota,

and Minnesota; and a few stockholders in each of Wisconsin and Michigan, where we divide jurisdiction with the Federal Reserve Bank of Chicago.

Here is the first anomaly. We possess no government capital, have stockholders, boards of directors, and a slate of officers chosen by those boards almost exactly as any private corporation. To put it more succinctly I need not be either Republican or Democrat.

Whether we are regarded as half public or half private, depends entirely on the context of the moment; a point which has been of considerable satisfaction to ~~one of a~~<sup>my</sup> Jesuitic turn of mind, and more importantly, a major underpinning of our cherished independence within the government.

It is also another manifestation of the federalism of our republic. Federal government is a dirty phrase in parts of our district where it is sometimes viewed as a single malevolent force bent on forcing a rigid pattern of conformity on all of us that neither reflects nor is responsive to the differences inherent in these United States. Like a shoe factory with a Washington address manufacturing only size 8 shoes. To a far greater extent than these disparing critics acknowledge, our government still reflects the spirit of the Federalist papers. Regionalism has a surprising vitality for a principle reported on a number of occasions to have died. In many of our political institutions, representation is guaranteed by their very nature. Such an institution is the Federal Reserve System.

Independence and regionalism: these two words are important, for each has its particular significance in what we do or don't do, as some are heard to observe.

At the center of this system is the wholly public part--the Board of Governors. Consisting of seven men appointed by the President for fourteen year terms, these men exercise a very loose supervision over

the banks, but in the main are concerned largely with monetary policy.

The reserve banks are also involved in the policy process, but in addition they do these things:

As housekeepers for the member banks, the reserve banks process checks. On a recent day we handled 1,100,000 checks at the Minneapolis Federal Reserve Bank. We also see to it they get currency and coin when they need them, store securities, and loan them money when they request it--and we consider it good for them. It is probably unnecessary for me to point out to any of you who have had to borrow from your bank, that these are not always parallel objectives. We hold their reserves--on June 30, 1967, we held about 2 billion in the System ~~Minneapolis bank~~. We are also a regulatory agency functioning through examination departments and policy decisions toward the laudable objective--achieved in the main--of a solvent banking system.

For the U.S. Treasury, we serve as fiscal agents. We issue bonds, and quite importantly, after a dividend of 6% to our stockholders, we remit most of our profits, ~~which last year at the Minneapolis bank~~ ~~amounted to~~                     .

For the public we attempt to perform our most important function--no less than a total effort to shape the economic environment, working with the tools of monetary policy--toward the goals of full employment, stable prices, and a favorable balance of payments. It is here the twelve banks, through presidents, and the seven governors converge in what is called the Open Market Committee. We meet every three or four weeks to determine an appropriate course for the ensuing period. You will notice I used the word "shape." No longer is our role solely the passive defensive one of responding to the pressures of the market. Some ten or fifteen years ago the System started a shift towards a dynamic creative role--

a move that has met with some successes and some failures. And certainly it has met with criticism from a number of quarters. But it seems to me the criticism is after the fact. It is generally accepted in Congress and by the public that we should develop alternatives to what in the past has been a stop-go economic policy.

That the country currently is enjoying only one of the goals enumerated is less a result of current monetary policy than a result of the monetary policy of 1966, when it was called upon to do more than it is capable to do. For in the mix of economic policy, monetary policy is only half the story. Fiscal policy which is the product of taxation and spending decisions of Congress and the executive branch of government is the other half.

Last year, as this year, fiscal policy was only partly brought into focus on the economy.

When it became apparent in 1965 that the pressures of Viet Nam were more than an economy geared to domestic expansion could stand, monetary policy had to move alone. By one means and another, the engine was braked, but not without an unnecessary wrenching, that nearly stopped the construction industry, caused severe problems to the savings and loan industry, and finally caused more than a few unpleasant moments for banks.

Whether all the things the Federal Reserve System did were necessary, I'll leave to the historians. Sufficient to say that action was necessary, and the overall result desirable as a national goal. It could have been more gracefully done if there had been a tax increase and fiscal restraint.

We are now looking at a picture not greatly different from October of 1965. While the executive branch now is pleading for fiscal action, the tax increase is hung up in Congress.

In 1965 the System had to rely excessively, perhaps, on its independence and move alone to curb the overheating which had become apparent in our economy. Because it had to act alone, it was called upon to force a measure of economic restraint by a monetary policy that was way out of proportion to the tools at its disposal. Although we were successful in the total objective, there were some casualties along the way: the disruption of the housing industry and the dislocation of savings and loans and commercial banks were two obvious examples of unintended by-products. By-products which could have been avoided if there had been concurrent fiscal action. As I said, we seem to be playing a reprise this fall with about the same script, but some change in the cast. It seems to me we are hung up on what are irrelevancies to the central issue of inflation, for we must remember an essential part of our current concern is timing.

What are these <sup>irrelevancies</sup> ~~alternatives~~? First there are those who are seizing upon this opportunity to air their frustration over <sup>military</sup> ~~monetary~~ policy and the issue of national interest in Viet Nam.

The second is a concern over purely domestic issues. This group argues that if we are in a war, where are the price and wage controls, the excess profits taxes and other parts of the national response to previous wars. Not seeing them they argue that their constituency is not aware that we are in a major war and are insistent upon a continuation and expansion of the social programs so necessary to attack the agonizing social problems of our day, such as the ghettos and rural America.

A third group <sup>is</sup> ~~are~~ concerned with fiscal restraint believing that the tax increase need not be of the dimensions requested by the President if there is a curtailment of federal spending.

Unfortunately, our national aims are a pretty complex package right now and nobody has come up with a very clear answer of which program is to be cut back, <sup>neither</sup> of is there much unanimity about the dollar figures.

Finally, there still exists a group that believe no tax increase is necessary anyhow, arguing that the economy is not overheating and inflation is not taking place.

These attitudes have hardened with only a limited dialogue taking place among the various groups. It is hardly a circumstance designed to satisfy the timing requirements which some of us believe are overpowering. There is no instant monetary policy, neither is there any instant economic policy. It takes time for the effect of monetary restraint, tax increases, and spending cutbacks to show up in the general level of business activity. So by failing to act now, for example, we are creating an economic climate for the second and third quarters of 1968.

*This is truly the wink of our discontent.*

~~In summary,~~ ~~We~~ have entered a tunnel that will become progressively narrower with fewer and fewer alternatives to turn. It is a hard fact, but true, that we are not invincible militarily, economically, and politically--something we are only now beginning to acknowledge. Having said that, I find considerable encouragement in the growing realization that this is so; this beginning may be the promise of the future. It is <sup>the</sup> ~~an~~ essential good sense <sup>of</sup> ~~in~~ the American people that has saved them from excesses in the past and I think with an increased awareness of what the alternatives are, there will be a response even though it may not come as promptly as ~~it~~ would be desirable. As an unabashed optimist I must believe that this is so.

FEDERAL RESERVE BANK OF MINNEAPOLIS  
OFFICE MEMORANDUM

**Date:** October 31, 1967  
**To:** Jim Duprey  
**From:** Eileen McGuire  
**Subject:**

Mr. Galusha just phoned from New York with the request that you supply some figures for him, which he will need by late this afternoon.

Total deposits in the U. S. banking system on any convenient date (for example, June 30).

Total deposits held by Reserve banks.

Ratio of deposits held by member banks to all deposits in the system.

Our own deposits on the same date.

Total number of checks we have handled at the maximum on one day (our own bank).

Milt will be meeting his plane at 6:32 p.m., and he is to take the information with him to the airport. I suppose Milt will be leaving the bank around 5:00 p.m. or shortly thereafter.

FEDERAL RESERVE BANK OF MINNEAPOLIS  
OFFICE MEMORANDUM

**Date:** October 31, 1967

**To:** Mr. Galusha

**From:** Jim Duprey

**Subject:**

- 1) Total deposits (demand plus time) of all commercial banks in the United States on August 30, 1967:  
\$356,340<sup>000 000</sup> million
- 2) Total deposits (demand plus time) of all member banks in United States on August 30, 1967:  
\$293,115 million
- 3) Ratio of (2) to (1)  
 $293,115/356,340 = 82.26\%$
- 4) Total deposits (demand plus time) at Ninth district member banks on August 30, 1967:  
\$7,734 million
- 5) Maximum number of checks handled on one day at Minneapolis Federal Reserve Bank:  
Number -- 1,099,219  
Date -- September 7, 1967