Remarks by

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It requires a certain temerity plus a general ignorance of the processes of utility regulation for a representative of the Federal Reserve to appear on your program. My guess is that if the gyrations of monetary policy have not complicated in a direct way your lives as regulators the last three years, they certainly have those of your constituency in the utility industries, and therefore indirectly yours. In a time when the trend of reliance on debt financing by public utilities has once again turned up, we have been making it increasingly difficult for them to predict rates and availability of credit. I need not remind you of the extraordinary variations in both of these money market variables in this period.

The Wall Street Journal, I think it was, had an article this spring on the shift in backgrounds of chief executive officers from operations or law to the financial side. And no wonder. The employment of money, either the corporation's own or other people's, is a most important factor in the success or failure of the contemporary enterprise. A knowledge of interest rate behavior, the probabilities of adequate credit sources, and the carrying forward of the broadest possible list of financial options, are the hallmarks of a successful corporate manager. Especially, I suspect, has this been true in the utility industry. Caught between relatively inflexible customer rates; the imperatives of an expanding U.S. economy which require almost continuous plant expansion with long leads and lags of planning, construction and cost recapture; and a monetary environment that can change dramatically within hours on occasion; the utility's financial officer has had one of the most challenging and frustrating jobs in American industry.

And there is no reason to expect it to become easier. It is entirely conceivable that interest rates will fluctuate, not only more frequently, but more widely in the future than they have over the long-term past. It is also quite possible that firms will find themselves periodically facing severe shortages of institutional funds, as they did in 1966 and have come close to doing in 1968. A statement with as unhappy implications as this requires justification. There are two reasons for believing that this may be so.

The first of these reasons has to do with our emerged role as banker to the world with enormous foreign holdings of liquid dollar assets and a central position in world trade. Our monetary posture is not only affected by the political and economic climates of other countries, but is a major influence on them as well. This requires that we conduct our affairs with one eye on developments around the world which impinge upon our economy and the strength of the dollar; while the other eye must be appraising the potential effects shifts in our monetary and fiscal policies may have on other countries.

An example of each might be useful to make this point credible. Foreign events which have affected us in significant ways in the last 24 months include the deterioration of the British economy; Vietnam; student and labor unrest in France. The list could be continued. All the resources of the international monetary system have been tested, and then some, in the last two years. Devaluation of the pound; closing of the gold pool; the freezing of monetary gold stocks; periodic pressures against various currencies, including our own, with the franc the latest to join the club. All of these have required an appropriate reflection in U.S. monetary policy.

At the same time, domestic pressures exerted by tightening U.S. monetary policy have forced the major U.S. banks to look to the Euro-dollar market, and which in turn has resulted in tremendous flows of short-term credit back to the U.S. The Voluntary Foreign Credit Restraint program, which has inhibited the export of U.S. capital by U.S. corporations to foreign countries for the construction and operation of overseas subsidiaries, has forced these same corporations to turn to foreign capital markets. When major U.S. banking industrial corporations enter the capital or money markets in any other country of the world, not excluding even the highly developed countries of western Europe, it produces demands and pressures against these markets of major dimensions. Inevitably nationalist political pressures appear to resist what one Frenchman has referred to as the American challenge.

And of course, the continued deficit in our balance of payments has contributed to inflationary pressures abroad. It is not an attitude of do-good or the Golden Rule that causes us to be concerned about our neighbors in the world, but a relatively newly developed attitude of enlightened self-interest. The realization that no modern nation can operate its fiscal and monetary policies in a vacuum has come as hard to the countries of western Europe as it has to the U.S. But come it has. One of the most encouraging developments of the last few years has been the appearance of an extraordinary degree of cooperation among central banks of the western world. Instead of pursuing narrowly defined national goals, these banks, including our own central bank, the Federal Reserve, have shown an extraordinary degree of cooperation in working out mutual responses to international monetary pressures. While in the short run some of these responses may appear against a country's national interest, the long-run payoff is no longer questioned.

Stability of exchange rates and preservation of the international monetary system are inextricably bound up in the preservation of the political systems in the separate countries. This has carried with it a certain loss of freedom on the part of each nation to be mischievous; or to put it more bluntly, perhaps to make a fool of itself. Countries like the United States that consistently run a deficit in their balance of payments can expect criticism from their peers and other countries, and if steps are not taken aggressively to attempt to redress the criticized situation, the offending country can expect disciplinary action which can be manifested in many unpleasant ways. This places a burden on policy makers, whether they be the determiners of fiscal policy or those in the Federal Reserve responsible for monetary policy.

Turning to the domestic side, this country is committed to goals of full-employment, stable prices and a substantial rate of economic growth. Again, as our society is organized, there are two ways of working towards these goals on the national level. One is through fiscal policy, which simply defined relates to the collection and spending of governmental revenues. The second is through monetary policy, which is the province of the Federal Reserve. The point has been made over and over again that these two policy streams must be coordinated if we are to have consistency in our progress towards attainment of these goals.

I'll not belabor this point because I'm sure it is accepted as an article of faith. Unfortunately, acceptance as an article of faith does not mean observance. If the recent past is any guide, fiscal policy is not going to be as flexible and responsive as our complex and fast-moving society requires. If this is so, and I desperately hope I am proven wrong, primary reliance will continue on monetary policy as a stabilization technique. It appears incontestable, for example, that government spending is going to fluctuate greatly over the coming years. If unrest continues, and there is no reason to believe that it won't, sharp changes in government spending will be necessary. Riots at home, like brush fire wars abroad, require that money be spent quickly in amounts geared to the requirements of what often turn out to be open-ended commitments. This would argue, then, that if government spending fluctuates and especially if it spurts sharply upward from time to time from a rising trend and tax rates are not responsive, then monetary policy will have to be flexible; which is another way of saying interest rates will have to fluctuate a great deal, caused in substantial measure by conscious and deliberate intervention in the money markets by the Federal Reserve.

At the risk of seeming immodest, I will say I have learned something in the last three years. It has been proven, I think, that too much should not be expected of the Federal Reserve System. It cannot be counted on single-handed to restrain inflationary pressures, or to forestall crises of confidence in the dollar.

Monetary policy is applied in a general way in the United States; that is to say, it cannot be deliberately aimed at special sectors of our economy. Monetary policy is largely applied by the nongovernmental sector through the countless decisions by the people who have money to lend and people who want to borrow, with each setting their own priorities. These priorities are determined with an eye to customer relations, interest rates, profit expectations, supplemental considerations such as participations, etc. The list could be continued, but no matter how long it got, national economic priorities would not appear. As a believer in letting the market place determine allocations of credit as much as possible, I still have to admit that this produces injustices during periods of acute credit stringency because it does not apply equally to all sectors. The housing industry in

1966 was an obvious example of a single sector bearing a disproportionate share of the burden of monetary policy. Money simply was not available for this industry at any price, which brings me to a point of controversy perhaps with some of you. My guess is that rate is no longer as important as we once thought it was. Most borrowers are more concerned with availability, assuming of course that they pay no greater rate than their competitors are required to pay. There are obvious economic ceilings of interest rates in terms of the ultimate business decision to go ahead or to cancel an expansion plan, but my guess is that these limits are much higher than have been traditionally thought. I am not sure that there exist many major psychological limits to interest rates. Even the home buyer who was a hold-out for so long at a 6 percent rate has surrendered. To put it another way, if a businessman or a consumer needs a capital good and must finance its purchase, rate considerations are less important than availability.

It is interesting that in many areas, including North Dakota, the real limit to responsiveness of interest rates to market pressures on the demand side may be the usury laws. Born because of the ingrained prejudices of human animal against money lenders and sustained by the populist tradition, usury laws have lost much of their relevance. As money has moved to a position of commodity, it must be bought and sold freely if it is to be responsive to public demand and distributed equitably around the economy. And here is where we run into an obstacle on the supply side. Savers are responsive to rates, and here is where another of our inequities in the uneven application of monetary policy emerged. Unless thrift institutions, whether they be banks or savings and loans, are able to compete freely in buying money which is their stock in trade, the investor or saver takes his money to the market place and buys the investment paying the higher rate.

This phenomenon, known as disintermediation, has been a painful experience for these thrift institutions forced to stand by and watch savers either slow down their rate of saving in their institutions, or reduce their accounts in real terms to buy securities paying rates substantially above those offered by the thrift institution. Congress, in an attempt to equalize the competitiveness of thrift institutions among themselves, that is to say, banks vs. savings and loans, passed a bill in September of 1966 authorizing regulatory agencies to set limits. Unfortunately while this may give a certain measure of insulation to savings and loans from commercial bank competition, it did not insulate the other group from market group competition, and this again has shifted the rate reaction to monetary pressure from these institutions to the money markets themselves; hence, the very sharp run-up in rates paid by utilities among other borrowers for their money in recent months. But my point is that there is no hope for it. The continued failure of this country to find a way to build flexibility and responsiveness in fiscal policy means the primary responsibility will continue on monetary policy. It is simply not designed to bring about massive changes in the U.S. economy. When it is so used, it is always going to produce great fluctuations and, as perhaps more importantly, changes in the availability of credit capacity. What this means for regulators of public utility industries, I am not quite sure. My guess is, though, a premium will be placed upon your flexibility and responsiveness to meet fluctuations in the financing capabilities of your constituency.