

UNIVERSITY OF MINNESOTA

Transcript of Question-Answer Session
following public lecture

"Effective Economic Policy: Some Key Requirements"

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- Q. Dr. Willes, the business community has had a lack of confidence, not knowing what the economic policy of the Administration is or where it's going. They have counted on Dr. Burns as sort of the mainstay of fighting inflation. From all reports, there's a high probability that Dr. Burns will not be reappointed as the chairman. What effect does one man, the chairman, have on the Federal Reserve's policies? If Dr. Burns remains as a member of the Board, will he continue to be a strong influence?
- A. Well, that's obviously the question I guess I am asked most frequently as I speak to various groups. Arthur Burns is a tremendously strong personality who has had enormous impact both within the Federal Reserve System and in government circles in general and he is in a position now where he has earned enormous respect on the part of businessmen and the public in general. I personally don't think the world will come to an end if he's not reappointed. I say that for two reasons. (He, by the way, was a professor of mine at Columbia and so I know him well. He disavows that he had anything to do with me and sometimes when I see what he does, I disavow I have anything to do with him.) The fact of the matter is when Bill Martin, who was his predecessor, was about to leave the Board of Governors, everybody said, "Nobody can have the credibility that Chairman Martin had!" And very quickly Arthur Burns had the same credibility and then some, and I think that would happen again. I'd like to think that our government institutions aren't dependent on one man. Second, the Federal Open Market Committee which is the primary committee that makes monetary policy, which consists of the seven members of the Board of Governors in Washington and then the twelve Reserve Bank Presidents, my counterparts all around the country, is now made up of a group of strong-willed, independent individuals. Frankly, I would not expect any perceptible change in monetary policy almost regardless of who is appointed to take his place.
- Q. Dr. Willes, you've spoken about the need for the consent and agreement of the public and yet many critics talk about the mystique that surrounds the Federal Reserve System. This week's Business Week, for example, asserts that regardless of who succeeds Burns, greater openness will be forced on

the central bank. Congressman Reuss states the case, "Ordinary people have to be able to understand what the Fed is up to." Do you agree, and I suspect you do, based on your speech here, that more openness is necessary and is likely to come and if so, specifically, what forms will such increased openness take?

- A. Well, that's an interesting question. I certainly do agree that we need to be more open. I was very surprised when I joined the Fed to find out I was part of a conspiracy and I've been trying to find out ever since where the conspiracy is. I haven't found it yet. And yet, very often in the public mind, we're considered to be part of some mystical group that gets together in secret and decides to overthrow the economy. I think a lot more openness is desirable but I think there are special ways, preferred ways to do that. We just had, this month, much to the chagrin of some of my colleagues...we invited two congressmen from this district to sit in on our Board meeting, one Republican and one Democrat just to keep it even, but I thought that was a perfectly appropriate thing to do. I think it's good for legislators to see very directly how we work and how we function; that we're not hatching secrets, that we don't do things in a mysterious way. On the other hand, some of the attempts of Congress to open us up, I think, are counterproductive. The typical request is to have us audited by the General Accounting Office. The concern that I and my colleagues in the System have about that is that that can very easily slip from a financial audit, where we have absolutely nothing to hide, where we're distressingly clean, to very specific attempts on the part of the General Accounting Office and the Congress to tell us how to conduct monetary policy. I don't think that is a productive kind of openness because one of the difficulties we face is that very often, the "right" economic policy may be right in the long run but very difficult in the short run. I don't think we want to be any more subject than we already are to the very short-run political pressures that might cause us to make some of the mistakes that I referred to in my talk.
- Q. Dr. Willes, in the case of the domestic steel industry, what do you see as the most favorable alternative, long-run, in regard to unemployment, retention of a basic industry, and a favorable impact on all related steel using industries?
- A. Was that asked by a steel vice-president? There are no good solutions to the problem of steel in my judgement. We have gotten ourselves into a bad position and we're going to have to pay the price to get out. What I would do, for whatever it's worth, and I have lost some of my best friends for saying this in public, but what I would do is allow, maybe even encourage, a reduction in the size of the steel industry in this country. We have a tremendous amount of inefficient steel generating capacity which is just not efficient; relative to that that can be produced in Japan and elsewhere. We ought to...let Japan send us steel, that steel which they can give us more cheaply, and we'll use our resources to produce other things. Obviously, I don't think we ought to eliminate the steel industry, but I don't think that's...you know people who talk about doing away with

the U.S. steel industry I don't think are being realistic. We're talking about changes on the margin and I think that we can be competitive with certain parts of our steel making capacity and for that part that we can't be, we ought just accept the cheaper Japanese steel and use our resources on other things. Now the human cost of that is very great. Those people who live in towns that are supported primarily by steel producing facilities and so on, would have tremendous dislocation and I think we have a responsibility to help them adjust and shift to other things, but we're going to have to make the adjustment sooner or later unless we want to permanently subsidize the U.S. steel industry. If we're going to have to make the adjustment sooner or later, seems to me we ought to be about the business of making that rather than trying to hold off the adjustment by raising barriers to imports of foreign steel.

Q. Would you comment with regard to the proposed substantial increases in social security taxes, number one, and secondly, is the proposed figure of full employment by 1983 realistic or should this figure of 4% unemployed be revised upwards?

A. The social security problem is a disaster. This has been one of those areas where, as a government, we found it easy to make nice promises and then figure out how we'll finance them later. Now people are beginning to understand that you can't do that forever. Again, there's no easy solution to that problem; we're going to have to do two things, in my judgement. We're going to have to start thinking about scaling down benefits, as difficult as that is to talk about, and then we're just going to have to increase the taxes that we pay to support it. Anybody who thinks that there is an easy solution to that problem is just being, in my judgement, outrageously misleading and mischievous. The proposed goal for unemployment of 4% by 1983...The main concern I have about the bill is that the government would actually try to do it. If it becomes, as some suggest, a "planning document" which is put on the shelf, fine. If you feel better about voting for it and then put in on the shelf, that's good. If the government really tried to achieve 4%, with the kinds of problems we have currently in our economy, what we would really get as a result is accelerating inflation. I don't think 4% is a realistic unemployment goal, given the structure of the labor market and the imperfections that we have at the moment.

Q. Dr. Willes, recently M-1 has been losing its significance to economists and business analysts because of developments of check credit and "NOW" accounts; would you please comment on that?

A. It is clear that things have been going on which change the way we should regard M-1, with electronic money and corporations being able to have savings accounts and so on. Interestingly enough, and I tried to indicate that I am not a monetarist, although I am often accused of that, but those who are of that persuasion have run a number of their kinds of calculations and have found that even with the changes in the demand for money that you referred to, the predictability of those equations and their value in analysis really hasn't changed very much. So to the extent that you agree

that's the right way to view the world, I don't think that anything significant has happened.

- Q. There are a number of questions here which are concerned about the very high recent growth rates in the money supply and wonder whether, one, you could explain them to people; why have you as the Federal Reserve System let that happen if it has such important effects for inflation and unemployment; and a related question is that some people would like to hear you comment on what relation, if any, some of this increase in the money supply may have had to recent Federal Government deficits?
- A. Just to rephrase the question, so I think I'm sure I'm answering the right one, why did we say that money was going to grow at 6 1/2% and it grew at 9%? [Right] The real reason is that we didn't want badly enough (we, meaning the collective Federal Reserve System) didn't want badly enough to keep it down. I read in the paper and magazines and so on all the time how the Fed can't control the money supply; I think that's a bunch of baloney myself. We can control it if we want to. Now, what's involved is that, this year, for example, if we had tried to keep the rate of money down, interest rates would have gone up sooner and faster than they did. My response is, you know, so what, because I guess I'm convinced that by not restraining the growth of money, what we in fact did is put in play a series of forces that are going to generate more inflation and that, in turn, is going to have a much more significant impact on long-term interest rates than anything that we would have done otherwise. So, unfortunately, the answer to your question is, we made a mistake and we deserve black marks as a result.
- Q. What is the major difference between monetarists and rational expectation theory?
- A. Monetary theory says that it is possible in one way or another, without going through the mechanism, to systematically influence what goes on in the economy. Rational expectations in effect says that it's not possible for monetary policy or fiscal policy to systematically influence what happens in the economy. That's obviously a gross over-simplification, but when I understand better I'll give you another answer.
- Q. This question says, "Can you suggest ways in which the plight of the non-land owning or young farmer might be ameliorated?" How can someone break into farming these days?
- A. That's an interesting question. How can somebody who can't inherit the land break into farming? I think that's a very serious question and one that I think we ought to work on a little bit. One possibility that occurs to me is that we ought to make it possible for wealthy people like you who have money to invest to help him break into farming. As it is now, with many of the statutes that we have in various states, the person, the farmer, he or she, has to either own the land himself or borrow to somehow make things work. In North Dakota, for example, there's a law against corporate farming. I think it would make a lot of sense to have "corporate farms" which would make it possible for people to

invest in the farm and let the farmer have a managing controlling interest and earn the results of his work and, in effect, have access to equity financing as well as debt financing. Now, when I've tried that out on a couple of farm groups they say, "Oh, my goodness, that means the demise of the family farm." In my judgement it means just the opposite of that. It means that we can find ways to help family farms remain and stay economically viable by giving him the financial resources that currently we only allow for corporations.

Q. Dr. Willes, here's a question submitted by one of our people that a lot of people facing retirement have to face. The person says, "I am sixty-four years old and must retire soon. Inflation is eroding my savings and my few bonds. Honestly, is there any real hope of relief? What can I do?"

A. I am not optimistic about the short-run outlook for inflation and I think those who are on fixed incomes have difficult days ahead because we have not...we continue to have policy makers and others who are putting in place a series of programs that, in my judgement, are going to mean higher, not lower, rates of inflation. It's only going to be when we have the courage and the realism to break that cycle that we're going to have any kind of long-run solution to the problem. I have great concern for those in the group that the question implied because I think the days are going to be very difficult indeed.

Q. Dr. Willes, I believe a banker has asked this question: "What is the future of the dual system of federally and state chartered banks?"

A. I think the future is great. It's going to require, in some states, more aggressive state regulators than we have. I see no indication that the dual system of banking is on the demise. In fact, I've seen a great resurgence of influence and interest on the part of state banking regulators and I think that's all to the good.

Q. This question reads, "I just looked at a sample financial statement for the U.S. Government that showed debt exceeded assets by a considerable amount. How can we expect to deal, in normal business fashion, with the situation?"

A. Oh, you couldn't! You'd be out of business long ago! I guess one of the implications of what I was saying is that I don't think the government can, either, for slightly different reasons. I mean, nobody's going to call the debt; we own the debt; we're not going to call it on ourselves. We can always pay the debt as a government; we just have to print the money to do it. The cost of the debt--the economic significance of the debt is what it has to do with inflation and that sort of thing. As I mentioned in my speech, I think the government deficit is far too high for this stage in the business expansion and I think that the only thing we can do in my judgement is collectively convince the politicians who vote on it that it's got to be lower.

- Q. This question says that your talk seems pretty pessimistic in terms of misguided government policies and lack of understanding and so on and your short-term outlook on a number of different issues, inflation and unemployment, doesn't seem very optimistic, either. What's your outlook for longer-term survival of the American economy as we know it in the free enterprise system?
- A. I personally think that we're at a very important juncture in terms of the United States economy and really more than that because economic problems and issues and how we deal with them tend to spill over and have enormous effect on social and political reality. I think we're at a crossroads. I think we can decide to continue to do what we've done in the past, in which case I would not be at all optimistic about the survival of the system as we now know it. Because I think that what we would have as a result of inflation and other things that would take place is persistent attempts to try and control that through wage and price controls and other kinds of government interference. We would end up with a very regimented, very highly controlled economic system, as we have in many other parts of the world who've gone down this same road. On the other hand, and maybe I have to think this way just in order to get up and feel good in the morning, but over the long sweep of history, I've always had an enormous regard for the American people--for their willingness to sacrifice when they understand what the real needs are. I just kind of have the feeling, if not the hope, in my bones that we'll have the courage to demand more responsible public economic policy. If we do that, even though it's going to hurt in the short run and we're going to have to make the sacrifices to make it work, then I think the long-run outlook would be very bright, indeed. Certainly, as I compare the United States with other countries in the world, with one or two very small exceptions, too small to hold all of us, there's no place that's better and I am still proud to be an American and delighted to be part of the system that's trying to work out the difficulties that we've talked about.