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The Fed in a Political World

The Rising Cost of Buying a New Home

Slowdowns and Recessions:
What's Been Government's Role?

FEDERAL RESERVE BANK of PHILADELPHIA

business review



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The Fed in a Political World

. . . Faced with pressures for greater political involvement, the Fed must remain increasingly open, responsive, and flexible, yet firm and far-seeing as necessary to do its job of securing a healthy economy.

The Rising Cost of Buying a New Home

. . . Although maintenance and taxes on a new home have increased at a slower rate than incomes generally, when combined with the carrying costs of the mortgage and soaring prices they outpace the rise in income.

Slowdowns and Recessions: What's Been Government's Role?

. . . Analysis of the severity of business slowdowns and of Uncle Sam's accompanying policy actions (fiscal and monetary) suggests that the Government's record in discouraging recessions has been spotty at best.

On our cover: This is part of Boathouse Row on the Schuylkill River in Philadelphia. It is the only such concentration of boathouses in the country. Built in the nineteenth century, the ten boating clubs that dot the river's east bank are listed on the National Register of Historic Sites. (Photograph courtesy of the Philadelphia Convention and Tourist Bureau.)

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The Fed in a



Political World*

By David P. Eastburn, President
Federal Reserve Bank of
Philadelphia

Anyone following the banking press at all closely will notice questions like these appearing frequently:

- Whether the Fed in the eyes of Congress is putting enough money into the economy to assure recovery.
- Whether it is proper for a Federal Reserve Bank to spend nearly \$80 for cigars.
- Whether the Fed should be audited by the General Accounting Office.
- Whether appointments of Federal Reserve Bank Presidents should be confirmed by the Senate.
- Whether the Fed will push up the money supply in order to help reelect President Ford in 1976 as some people allege it did for President Nixon in 1972.

There is a strong *political* overtone to each of these questions. Yet, it is frequently said that the Fed is *nonpolitical*. Which is it? Are we political, or aren't we? A simple "yes" or "no" answer, I'm afraid, is just that—too simple. A more realistic way to phrase the question is: *how political is the Fed and in what sense?*

In a broad sense the Fed must be part of the political process. Politics is the art of government—in our system, representative government. Government must do what the people want; politics is the process of discovering what they want and how to get it for them.

Accordingly, the Fed must be responsive to the public. To say that it is nonpolitical—at least in this broad sense—implies that the Fed knows better than the people themselves what they should have. This is an elitist view inconsistent with our form of government.

Yet, there is something special about the Federal Reserve. It manages the money supply. A lesson in history is that sovereigns frequently have abused their power to manage money. Some years ago we published an

*A lecture delivered at the Graduate School of Banking, University of Wisconsin, Madison, August 11, 1975. The views expressed are mine and do not necessarily reflect those of my colleagues in the Federal Reserve System.

analysis of this history which pointed out how Henry VIII at one time became known as Old Copper Nose.¹ The reason was that once he needed money and called in all the silver coins, and melted and recoined them with a copper base. As the new coins became worn and blotched, the most prominent part of Henry's features, his nose, protruded through the thin silver coating in a dull relief of copper—hence, Old Copper Nose. Even our own George Washington was saddled with the problem of paying his troops with paper money that declined so precipitously in value that the Continental dollar cost more to print than it was worth as money.

Given this long history of abuse, the founders of the Federal Reserve System had good reason for insulating the Fed from narrow political pressures. The Fed is non-political in this sense. Its fortunes are not tied to the reelection of any Government official. It is for this reason that any official in the Fed properly resents allegations that policy has at any time been slanted to influence elections. Having either observed or participated in meetings of the Open Market Committee for a decade and a half, I can recall not a single instance when this motivation was present either explicitly or implicitly.

There is constant tension between these two concepts—being responsive to the public in the broad sense and being insulated from narrow, short-run politics. This tension characterizes much of what happens in the Fed. It is seen in what we do and how we do it.

WHAT THE FED DOES

This is *the* biggest political issue because it is *the* most fundamental. It has to do with the kind of economy the people want. Let me make a generalization that is oversimplified but nevertheless says a lot about the environment in which the Fed operates: political

¹"Henry VIII Revisited: The Problems and Temptations of Money Creation," *Business Review* of the Federal Reserve Bank of Philadelphia, January 1960, pp. 3-18.

liberals tend to advocate full employment policies, conservatives a stable dollar. The emphasis given to these objectives shifts over time. Last year public opinion polls indicated that inflation was the number one problem. Now it is unemployment. The Fed finds itself constantly in the middle, trying to reconcile these two views. For example, in recent Congressional hearings some experts argued for increasing money at the rate of 10 percent a year in order to reduce unemployment. Others argued that money growth should be kept considerably below this rate because of the fear of resumption of double-digit inflation.

The official Fed position is that unemployment is the short-run problem, and that we should try to facilitate recovery and bring down unemployment. Inflation, though, is the long-run problem and we must be careful not to rekindle it. Overstimulating the economy now to achieve greater success on the unemployment front is likely to produce another round of double-digit inflation later. The Fed must keep an eye on both the short and long run when making policy. I agree with this position but would feel better about it if there were stronger Government programs to deal with unemployment by other means. These include liberalized unemployment compensation and more vigorous commitments to public service jobs, more effective training, and a more enterprising minimum-income program.

The pushing and pulling between the objectives of stable prices and full employment, whatever the outcome today, will be a political struggle which will be with us for a long time. It involves value judgments on which people have strong differences.

HOW THE FED DOES IT

Dispersion of Power through Organization. Political considerations strongly influence the ways in which the Fed goes about accomplishing its objectives. They are reflected first of all in its *organization*. The Federal Reserve Act was very much the result of a

political process and the founders of the System had political considerations in mind when they hammered out the organizational framework.

Internally, the organization emphasizes dispersion of power. In this sense, the organization of the Fed parallels that of government. Heading the System is the Board of Governors—seven Governors, not one as in most other central banks—appointed by the President and confirmed by the Senate. As a further dispersion of power, the Fed has 12 semi-autonomous Banks. Each Bank has a Board of nine Directors. Three come from banking, three from the ranks of borrowers, and three (those appointed by the Board of Governors) from the public at large. The Federal Open Market Committee (which has the major responsibility for monetary policy formation) is a combination of the Board of Governors and Presidents of Federal Reserve Banks. The Federal Advisory Council is a group of bankers which advises the Board of Governors. This is a complicated mixture of different groups designed to avoid concentration of power in one person or place.

Authority over policy tools is also distributed. The Board of Governors determines reserve requirements and sets many regulations, such as Regulation Q and margin requirements. Open Market operations are governed by the Federal Open Market Committee. The discount rate is set by each Board of Directors subject to review and determination by the Board of Governors.²

In all these arrangements the Board of Governors has most of the power and this is as it should be, but the decentralized nature of the organization and the decision-making

process provides an internal balance to this power. Although it is inevitable that power relationships will change in this kind of an administrative situation, the “dispersion principle” is so fundamental to the Fed and the national interest that power shifts over time should be back and forth rather than in one direction—offsetting instead of reinforcing.

Externally, the organization provides insulation from certain kinds of political pressure. The 14-year terms of the Governors are designed to protect them against short-term swings of partisan politics. This arrangement enables the Governors to give appropriate weight to the long-run consequences of policy decisions. Without these long terms, Governors would be subjected to political pressures to achieve short-run changes in the economy, possibly at the expense of what is best for the economy over the long haul.

In my view, this complex organization provides adequate insulation against political pressures. However, some minor modifications could be made. First, as has been proposed by several commissions in the past, the term of the Chairman of the Board of Governors could be made to coincide with that of the President of the United States. Second, shorter terms for Governors, say ten years, could be provided without much risk. Third, a couple of the provisions which Senator Proxmire has indicated he will introduce in a bill to reform the Fed could be accepted without causing any harm.³ One of these would have the Chairman’s term subject to approval of the Senate. This would enable Congress to have somewhat more control over general monetary policy. A second would require that consideration be given to candidates from consumer and labor groups when making appointments to the

²Reserve requirements set the amount of reserves that member banks are to hold. Regulation Q places a ceiling on all interest rates paid by member banks on time and savings deposits. Margin requirements set the cash down payment required when purchasing stock on credit. Open Market operations—the buying and selling of securities by the Fed—affect bank reserves, interest rates, and the growth of the money supply. The discount rate is the interest rate which the Fed charges member commercial banks that borrow from it.

³U.S., Congress, Senate, Housing and Urban Affairs Committee, *S. 2285: A Bill to Amend the Federal Reserve Act to Provide for Senate Confirmation of Certain Appointments, and for Other Purposes*, 94th Cong., 1st sess., 3 September 1975.

Board of Governors. I don't believe this is necessary since members of the Board consider it their responsibility to look out for the concerns of these groups among others. Moreover, it would be undesirable to begin constituting the Board with members who view themselves as advocates of special interest groups. Nevertheless, I see little harm in giving "due regard" to individuals from consumer and labor interests in considering appointments.

I do see positive harm, however, in the other proposals Senator Proxmire has made. Most of all, it would be highly undesirable to have Congress make appropriations for Federal Reserve expenditures. This would involve Congress in details of Fed policy and operations which, as I'll indicate shortly, Congress should not and cannot effectively undertake. I would also oppose having appointments of Presidents of Reserve Banks subject to Senate confirmation. On the surface this appears to strengthen the hands of the Presidents in serving on the Open Market Committee, but it promises to politicize their appointments, to undermine the role of the local Board of Directors, and to open up a number of undesirable issues with regard to employment status and compensation. Finally, the provision to provide staff assistance for individual Governors is a detail which can be handled best by internal administrative arrangement.

Fed Philosophy: Free Markets versus Credit Allocation and Fine Tuning. A second way in which political considerations influence how the Fed does its job is in the *philosophy of operation*. Let me make another generalization that is somewhat oversimplified but nevertheless goes far to explain many conflicts: the Fed tends to emphasize the free market; many politicians tend to emphasize intervention in the free market and fine tuning.

This difference is seen first of all in the allocation of credit. In emphasizing the free market the Fed traditionally argues that the

economy works best with least detailed intervention. The economy does need overall regulation in the sense that, as Walter Bagehot⁴ said, money will not manage itself. But the Fed has considered its job simply to be one of regulating the overall supply of money and credit and leaving it to the market to allocate that credit. However, there are those who believe that the market doesn't do the job well. It allocates credit in a manner that is incompatible with their view of social priorities. For example, during periods of tight money the market allocates credit in a way that severely affects housing and small business. Yet, many individuals rank these sectors of the economy high on their lists of social priorities and seek methods of shielding them when credit is tight.

This is a matter that greatly concerns many people and it is not going to go away. It is also one for which I happen to have a good deal of sympathy. Undoubtedly, one approach is to do what we can to improve financial markets. Ceilings on interest rates, for example, limit the free flow of funds, often to the detriment of "high priority" sectors of the economy. The Hunt Commission (President's Commission on Financial Structure and Regulation) tried to get to the heart of this problem by its recommendations for sweeping changes among financial intermediaries. Improving markets is all to the good, but it is likely to happen slowly and with difficulty. Another approach is for the Federal Government to intervene in markets through fiscal action. In recent years, the formation of a number of Government mortgage agencies has been effective in helping the housing sector. Such actions are a more direct method of providing funds. The problem with them is that Government may become involved in credit markets to a greater extent than desired.

⁴This nineteenth-century English economist, political analyst, and editor, was a practically trained theorist on banking and financial matters. His *Lombard Street* (1873), written to explain the necessity of keeping a greater reserve in the hands of the Bank of England, helped formulate the modern theory of central banking.

Finally, this leaves us with selective credit controls.⁵ This is a possibility that has always had a great deal of appeal to me. Unfortunately, there is a real question as to whether such controls work. Representative Reuss's proposal to place differential reserve requirements on different kinds of assets, for example, is an intriguing possibility. Our analysis of this, however, raises practical problems. If the Fed were to try to encourage banks to make mortgage loans by putting a low reserve requirement against them and discourage banks from making business loans by putting a high reserve requirement against them, other lenders would more likely begin to fill the gap left by commercial banks. If controls were applied to these other lenders, the open market could move in to close the gap. We could find ourselves in a costly strait jacket of credit controls.

In my view, no one has *the* answer to the question of credit allocation. I'm certain only of one thing: the Fed cannot afford to ignore it and despite practical and philosophical problems should continue to study all possibilities.

In addition to those focusing on the allocation of credit, there are others who advocate fine tuning the money supply and interest rates. We are, of course, familiar with the longstanding dispute between the monetarists and the fiscalists with respect to fine tuning the economy. What's not always appreciated, however, is that both schools have their fine tuners.

Traditional monetarists are mostly anti-fine tuning. They argue that if the Fed tries to vary the rate of growth of money it will do more harm than good. Consequently, it should simply aim for constant growth of money regardless of what happens to interest rates. A new breed of monetarist—one who pores over weekly money supply figures in great detail—has been developing. He puts great

stress on very short-run movements in the money supply. Financial houses, for example, put out letters which make mountainous interpretations out of molehill changes in the money supply.

Most of us in the Fed take an eclectic view of the money supply and interest rates. Both are important. On fine tuning, we believe that money growth should not be constant but know from experience that it cannot be controlled precisely. At the same time, to be honest, there is often in the Fed a tendency to pay undue attention to small fluctuations in interest rates. Hopefully, we're getting over that syndrome.

I hope also we can avoid the syndrome of fine tuning the money supply, but it is clear to me that as attention paid to the money supply has grown there has been a tendency to expect too much precision in controlling it. I believe we should try to smooth out extreme movements without yielding to the temptation of trying to *eliminate* all unwanted movements in money. To do even this much smoothing of the money supply will mean we will have to permit more flexibility in money-market rates.

There are a few modifications that would be helpful in this regard. The first has to do with making information about monetary policy decisions more readily available. The Fed now announces its Open Market decision 45 days after the fact. This departure from secrecy has done much to dispel the belief that financial markets would be unduly disturbed or that large financial firms would gain an unfair advantage in money markets. In my view, the next step is to move to a 30-day delayed announcement. If this action has no damaging impact, the immediate announcement of policy decisions should be considered. More information of this nature would promote better understanding of the Fed and its decision-making process.

The second modification has to do with improving money-stock control by the Fed. Member banks have been leaving the System primarily because they must forego earnings on the reserves they are required to hold

⁵Two bills currently pending in Congress would have the Fed direct some form of selective credit controls: S.887 sponsored by Senator Richard S. Schweiker and H.R. 212 sponsored by Representative Henry S. Reuss.

while their nonmember counterparts often are permitted to earn interest on a portion of their reserves. Declining membership means a smaller portion of the nation's stock of money is directly influenced by the Fed. To give the Fed greater control over the money supply, I support legislation that would establish uniform reserve requirements for all commercial banks. An alternative that would also resolve the problem is Congressional action to permit the Fed to pay interest on member bank reserves. While either change would not be a cure-all, it would enhance the Fed's chances of achieving its monetary policy goals.

In sum, it is clear to me that all this pressure for fine tuning and improved credit allocation reflects something basic in our society—the rising standards expected of public officials. It reflects the fact that people are not content to watch the market exert what they consider adverse effects on sectors they are concerned about. It reflects increasing pressure for intervention in markets and demand for greater precision in controlling them. But it is also clear that the state of the art is not up to these demands and that this conflict between rising expectations and limitations of performance will continue to be a source of political dispute. As the conflict continues, I believe the Fed should stand by its free-market philosophy but it cannot ignore these pressures or take an extreme *laissez-faire* view in dealing with them.

Intragovernmental Relations: A Delicate Balance. A third way in which political considerations are reflected in how we do our job is in the *relation to the Executive and Legislative branches of Government*. The Fed reports to Congress, not to the President. The reason for this is the history of the abuse of money by the Executive. The Secretary of the Treasury was once an ex-officio member of the Federal Reserve Board. He was removed because he has to borrow money to pay the bills and might have a tendency to want the lowest possible interest rates.

Yet, the relationship between the Fed and

the Executive branch is a very delicate arrangement. Obviously, monetary policy cannot go completely off on its own without some coordination with the Government's economic organization. Much consultation and coordination goes on—say 99.99 percent of the time. The important thing is to preserve a degree of independence needed for that .01 percent of the time—that rare and extreme situation in which the Fed disagrees fundamentally with the President. This is the meaning of “independence.”

A special case in the Fed's relationship with the Executive branch has to do with Treasury financing. The Federal Reserve System has a great responsibility to see that a new issue of the Treasury does not fail. At stake is the credibility of the Government's credit. There is a danger, of course, in going too far in this direction as we learned during and immediately after World War II. At that time, the Fed supported prices of Government securities to the point where it had become “an engine of inflation.” This problem was solved in 1951 when the Fed and the Treasury reached an *Accord* by which the Fed gave up its support of the Government securities market. In return the Fed ever since has pursued an “even keel” policy during periods of Treasury financing. This policy in effect pledges the Fed to a position of neutrality while the Treasury is raising money.

In times when the Treasury is almost constantly in the market, even keel could seriously erode the Fed's flexibility in changing policy. However, in recent years, particularly as the Treasury has evolved new methods of financing, even keel has gradually been getting more flexible. This is no longer a critical problem in the relationship between the Fed and the Executive.

A more difficult question currently has to do with the Fed's relationship with the Legislative branch. The Federal Reserve is a creature of Congress. Congress can take any action it wishes with respect to the Fed, including abolishing it. The immediate question is how much should Congress be involved in

the details of monetary policy. The Constitution gives Congress the power to coin money and to regulate the value thereof. But this leaves open the question of how much authority it should retain and how much it should delegate to the Fed. I believe it is clear that Congress should retain general oversight but should allow the Fed enough room to make unpopular decisions in the short run that will prove wise in the long run. Also, Congress should not involve itself in the details of monetary policy. For one reason, Congress can be just as susceptible to temporary political pressure as the President. For another, Congress lacks the necessary expertise in monetary policy formation and in its implementation to be calling the day-to-day or even month-to-month monetary signals.

Earlier this year both houses passed a resolution which provided for more direct control over monetary policy.⁶ This was a proper step and promises to help focus policy on longer-run objectives. It remains to be seen, however, if Congress uses the tool effectively. As the Fed and Congress proceed to feel their way under the concurrent resolution, a great deal of cooperation and good faith will be necessary on both sides.

A final aspect of Fed-Congressional relationships has to do with the proposal to have the General Accounting Office audit the Federal Reserve System. I can speak from personal experience that the Fed is thoroughly audited now. I can understand that in a post-Watergate environment there would be a desire to provide for the assurance that the

billions of dollars of assets are all there. As has been pointed out many times, however, the danger in the proposal is GAO involvement in monetary policy. The Fed already reports all policy actions to Congress and the concurrent resolution further strengthens that reporting relationship. The GAO is not well-equipped to interpose itself between the Fed and Congress on the matter of monetary policy.

CONCLUSIONS

Politics is an art. Central banking is an art. This means that there are no absolutes and that political influences are constantly fluid. For example, recently the emphasis on consumerism has involved the Fed in Truth in Lending, Fair Credit Billing, and Equal Opportunity in Credit. This additional responsibility promises to involve the Fed even further in political considerations. An irony of this is that the Fed tends to get these jobs because it is regarded as nonpolitical.

Thus, pressures toward greater political involvement for the Fed are increasing. Awareness on the part of the public of the Fed is greater than ever. Opinions about what the Fed should do are more pronounced than ever. Pressures on Federal Reserve officials to perform better are greater than ever. Demand for information about what they are doing is stronger than ever. If there were times when officials could sit in their marble halls and mysteriously pull strings that affect the economy without anyone questioning their actions, those times are gone. We must be increasingly open, responsive, and flexible. The challenge will be to accomplish this and yet be as firm and far-seeing as necessary to do our job of securing a healthy economy.

⁶U.S., Congress, Senate, *Referring to the Conduct of Monetary Policy: Report to Accompany H. Con. Res. 133*, 94th Cong., 1st sess., 17 March 1975.

RESEARCH PAPERS AVAILABLE

The Philadelphia Fed's Research Department occasionally publishes RESEARCH PAPERS dealing with a wide range of banking and economic issues. Most of these papers are of a highly technical nature and for the professional researcher.

- *Intradistrict Distribution of School Resources to the Disadvantaged: Evidence for the Courts*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe
- *Branching Restrictions and Commercial-Bank Costs* by Donald J. Mullineaux
- *Economies of Scale of Financial Institutions* by Donald J. Mullineaux
- *Required Reserve Ratios, Policy Instruments, and Money Stock Control* by Ira Kaminow
- *The Information Value of Demand Equation Residuals: A Further Analysis* by James M. O'Brien
- *Equality of Educational Opportunity Quantified: A Production Function Approach*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe
- *Pennsylvania Bank Merger Survey: Summary of Results* by Cynthia A. Glassman
- *Manual on Procedure for Using Census Data to Estimate Block Income*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe.
- *Block Income Estimates, City of Philadelphia: 1960 and 1970*, Philadelphia School Project, by Anita A. Summers and Barbara L. Wolfe
- *Optimal Capital Standards for the Banking Industry* by Anthony M. Santomero and Ronald D. Watson
- *A Unified Model of Consumption, Labor Supply, and Job Search* by John J. Seater
- *Utility Maximization, Aggregate Labor Force Behavior, and the Phillips Curve* by John J. Seater
- *Economies of Scale and Organizational Efficiency in Banking: A Profit-Function Approach* by Donald J. Mullineaux
- *On the Role of Transaction Costs and the Rates of Return on the Demand Deposit Decision* by Anthony M. Santomero

Copies of these are available from the Department of Research, Federal Reserve Bank of Philadelphia, Philadelphia PA 19105.

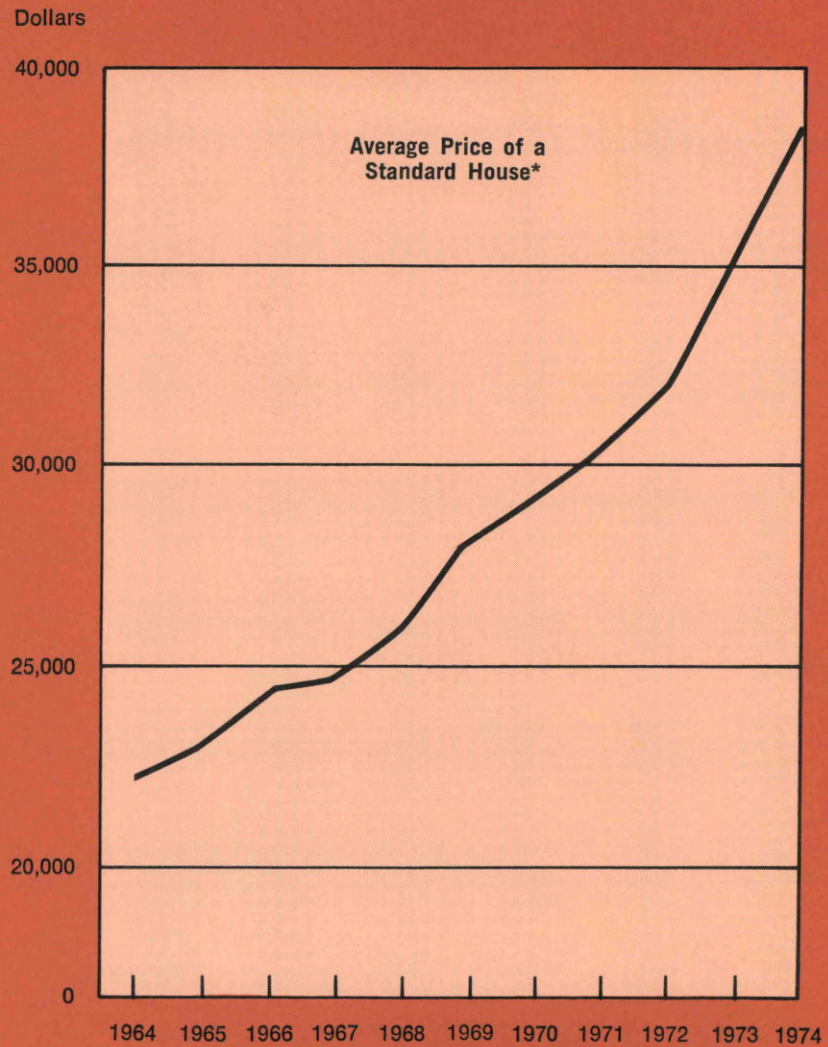
THE RISING COST OF BUYING A NEW HOME

By James J. Bacci



CHART 1

WHILE THE PRICE OF A NEW SINGLE-FAMILY HOME HAS NEARLY DOUBLED IN THE PAST TEN YEARS . . .



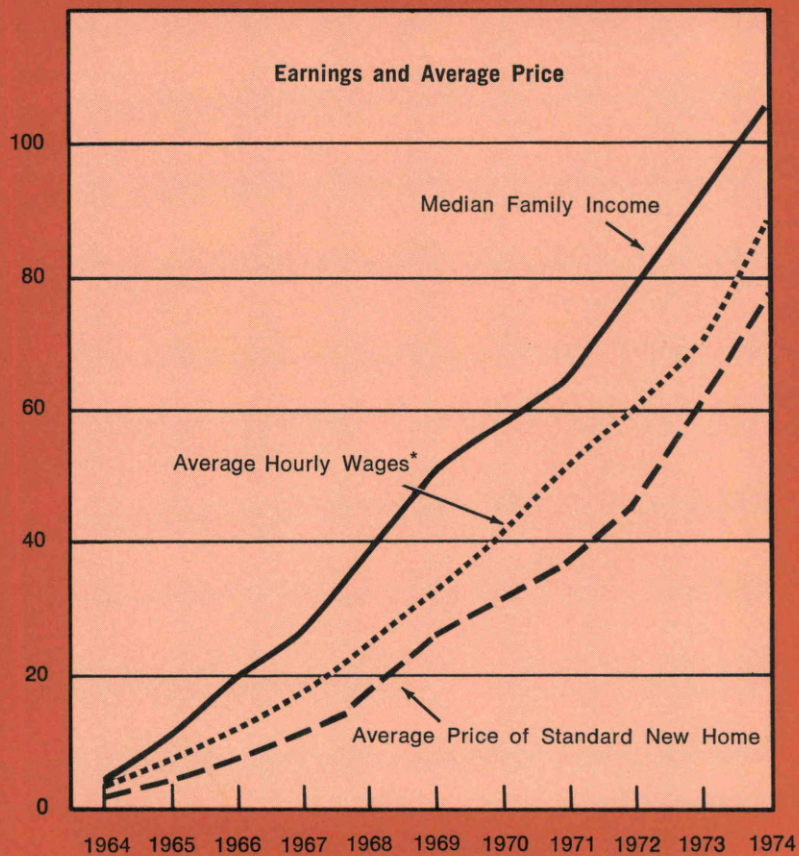
* Estimated price of a constant quality home, with amenities such as number of stories, floor area, number of bathrooms, central air conditioning, and type of foundation held constant.

SOURCE: U. S. Department of Commerce, *Construction Review*.

CHART 2

. . . INCOMES HAVE IN GENERAL, RISEN SLIGHTLY FASTER.

Percent Increase Since 1963



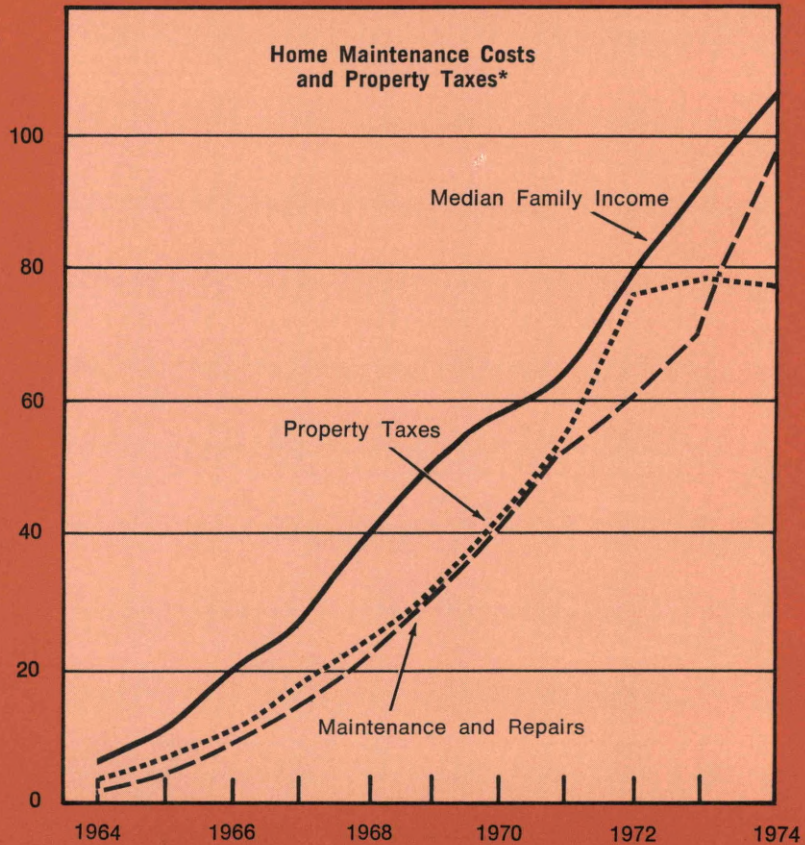
* Hourly earnings of nonsupervisory workers on private nonagricultural payrolls.

SOURCE: U. S. Department of Commerce, Bureau of Census, *Consumer Income*; *Construction Review*; U. S. Department of Labor, Bureau of Labor Statistics.

CHART 3

AN EQUALLY IMPORTANT MEASURE OF THE REAL COST OF HOME OWNERSHIP, HOWEVER, IS THE CARRYING COST OF THE PURCHASE. IN THE LAST DECADE BOTH MAINTENANCE AND TAXES ON A STANDARD HOME HAVE INCREASED, THOUGH AT A SLOWER RATE THAN THE RISE IN INCOMES.

Percent Increase Since 1963

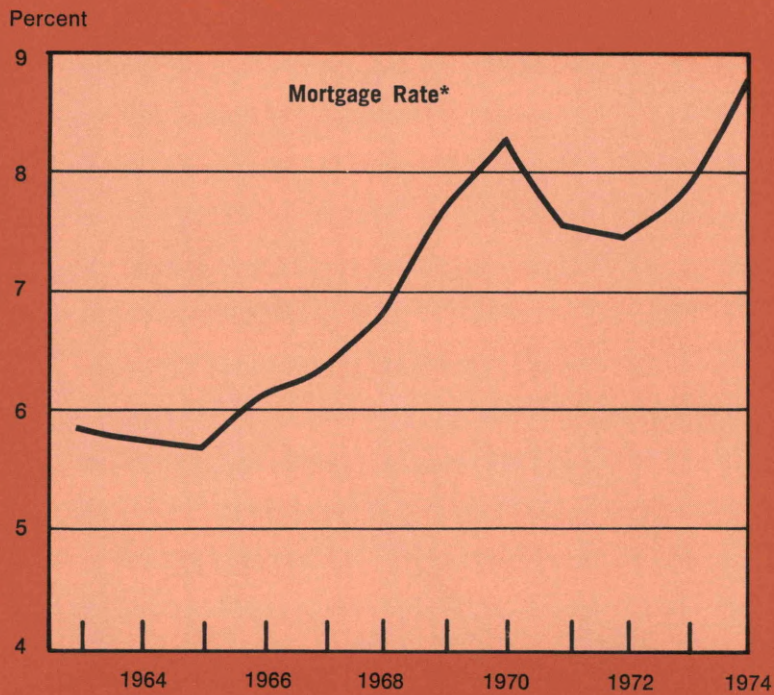


* Based on a constant quality house.

SOURCE: U. S. Department of Labor, Bureau of Labor Statistics.

CHART 4

BUT, WHEN MORTGAGE COSTS ARE COMBINED WITH THE ESCALATING PRICE OF NEW HOMES . . .



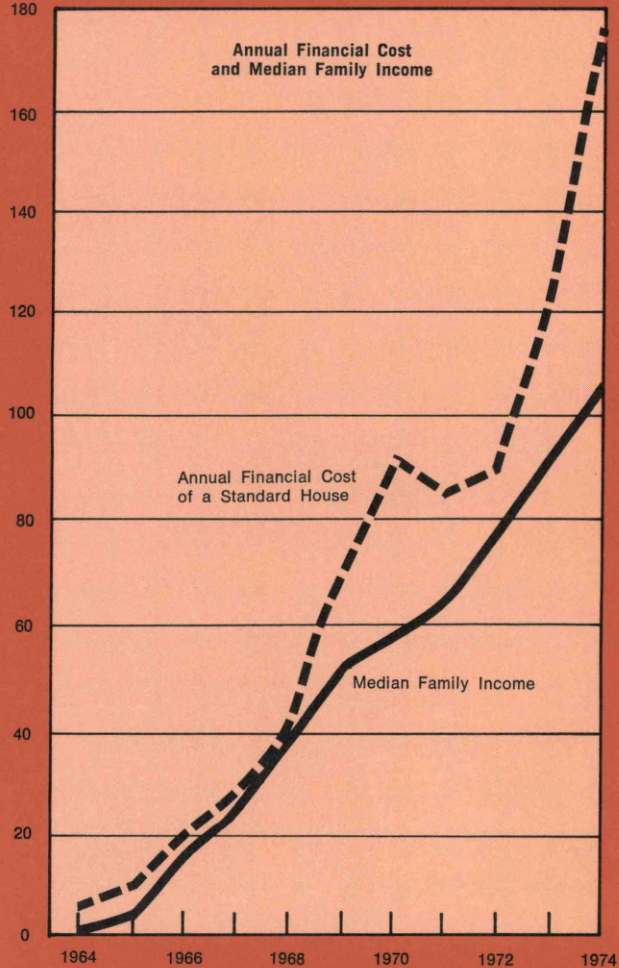
* Average contract rate of interest for mortgages on new home purchases in each year.

SOURCE: Federal Home Loan Bank Board.

CHART 5

... (SOMETIMES REFERRED TO AS THE "FINANCIAL COST"* OF PURCHASING A NEW HOME) THE TWO TOGETHER HAVE OUTSTRIPPED THE RISE IN INCOMES.

Percent Increase Since 1963



* The yearly financing cost of standard new one-family home purchased in each year, defined as the contract mortgage rate times the average purchase price. It includes both the opportunity cost of personal funds employed and the interest cost of the mortgage. Homebuyers have the choice of financing their home with a mortgage and paying the going rate, or employing personal funds to make the purchase. If personal funds are used, the buyer's cost is not the mortgage payment but the opportunity cost of the interest lost by not being able to invest those dollars in other long-term investments.

SOURCE: U. S. Department of Labor, Bureau of Labor Statistics; U. S. Department of Commerce, Bureau of Census; Federal Home Loan Bank Board.

Slowdowns and Recessions: What's Been Government's Role?

By Donald L. Raiff

All industrialized countries have their economic ups and downs, and the United States has had its share. Between 1950 and 1970 we went through seven slowdowns and the best guess of the experts is that the eighth one ended this spring. This latest experience turned out to be the deepest drop-off since World War II.

Are these fluctuations inherent in our economic system or has some outside force caused them? Some economists have suggested that changes in Government policy may be a cause of this instability or, at least, be aggravating the swings. Analyzing the severity of slowdowns and Government policy actions which accompanied them provides some insight into this question.

SLOWDOWNS AND RECESSIONS: SEVERITY IS THE ISSUE

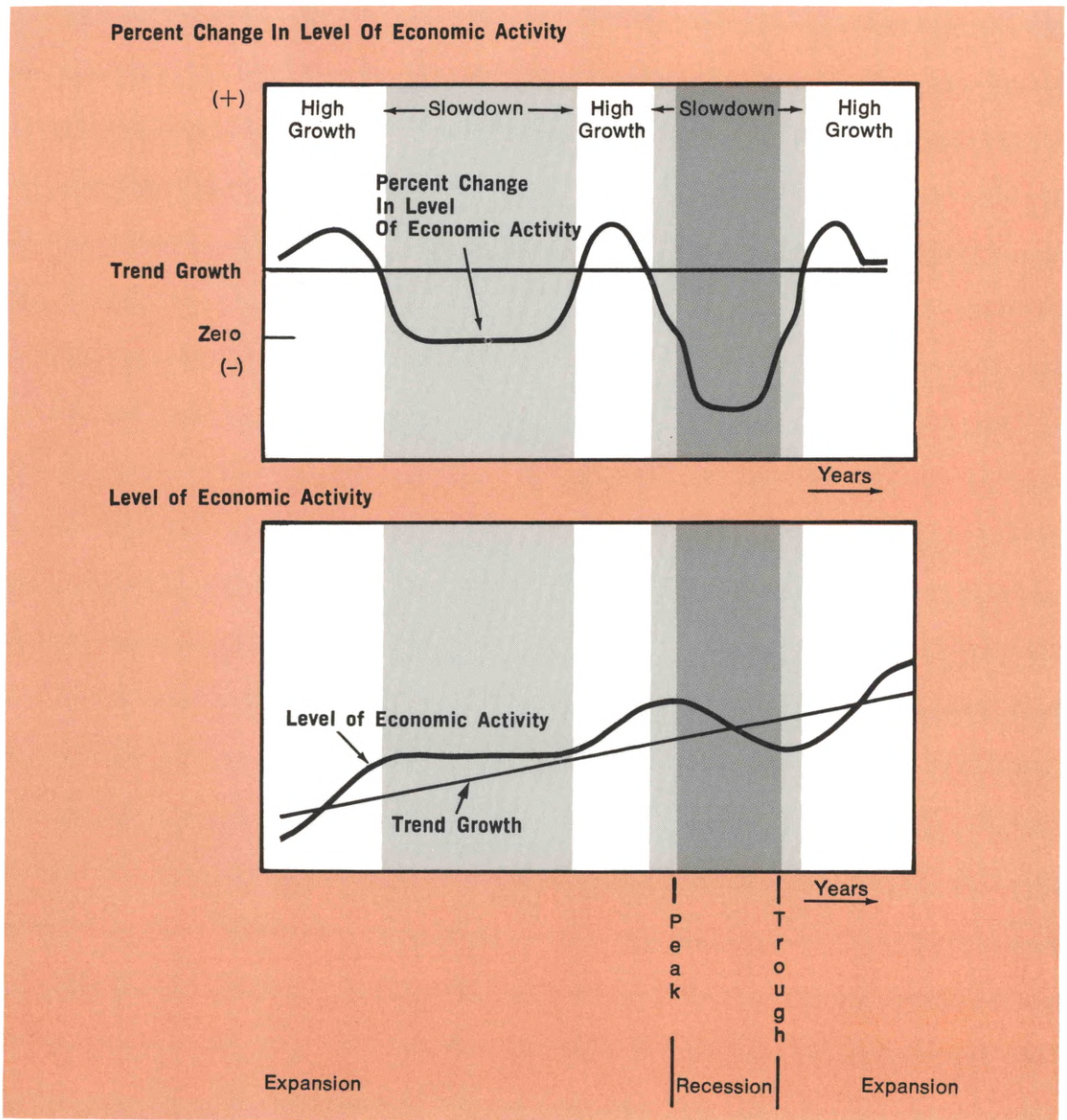
In technical jargon, economic slowdowns

are deviations *below* the trend of long-term growth. They include periods of *slow positive growth* as well as actual declines in economic activity. (For an illustration, see Figure).¹ The severity of these slowdowns varies greatly. Some “slowdowns” are worse than others, and the business declines are tagged “recessions” (a really bad downturn, like in the 1930s, is labeled a depression). For example, of the seven slowdowns between 1950 and 1970 three weren’t serious enough to qualify as recessions and four were. Accord-

¹For a long time the National Bureau of Economic Research has produced and studied a chronology of business cycles. This effort distinguished *only* between periods of positive growth (lumping together periods of high and low growth) and declines in the level of economic activity—recessions. For an introduction to a more recent and general framework used in this article, see Ilse Mintz, “Dating United States Growth Cycles,” *Explorations in Economic Research* 1 (1974): 1-113.

TWO VIEWS OF THE SAME HYPOTHETICAL ECONOMIC ACTIVITY

The top graph is the percentage change representation of the lower one. Together they illustrate the occurrence of two slowdowns, the first one displaying a period of mostly zero growth. The second experience shows a slowdown becoming a recession, as below-trend growth yields to a period of decline in the level of economic activity.



ing to the percentage change in output, the worst recession was in 1957-58 and the mildest slowdown was the mini-recession of 1966-67. (See Appendix Table A for a complete ordering, 1950-70).

Analyzing “slowdowns” rather than just recessions allows us to distinguish between

periods of sluggish growth and those characterized by actual declines in business activity. This separation of “plateaus” from “valleys” may provide insights into stabilization efforts, especially if the severity of the slowdown is related to differences in the accompanying Government policy. (See Box 1.)

BOX 1

INGREDIENTS FOR A COMPLETE EVALUATION OF STABILIZATION POLICY DECISIONS

An in-depth look into the quality of stabilization policy would need to identify three things: the goals of the policy actions, the information available at the time of each decision, and the thrust of any policy changes. The ideas and data in this article present only a “first glance” at such a complete evaluation.

The evaluation in the article is limited to the goal of preventing severe slowdowns in the rate of economic growth. A thorough appraisal of policy would also consider other legitimate goals of policymakers—for example, reducing the rate of inflation.

Also, we make no mention of the forecasts existing at the time of relevant policy changes. It is possible that errors in the forecast are an important force leading policymakers astray in charting their course. Even though there is some evidence that the shapers of monetary policy can recognize impending slowdowns and recessions before they arrive, there is no documented evidence that these officials—nor their counterparts in fiscal policy—can accurately predict the magnitude of the impending slowdowns.* Their decisions should be assessed in light of the information available at the time.

To complete an evaluation, the thrust of policy actions must be carefully mapped. Yet, there is no widespread agreement about which variables best measure the thrusts of each policy, or about the time-lags between a policy move and the result.** Each of these issues must be confronted and the “best” available indicators used to reach conclusions. For example, evaluating monetary policy may involve a decision of whether to use interest-rate movements or changes in the growth rate of money as an indicator. Even if the latter indicator is accepted, one must then select the most appropriate definition of money.***

The tests presented in the article do not demonstrate all of the successes and failures of stabilization policy. However, they do provide some insight into one of the issues raised by its critics—the role of policy in aggravating slowdowns.

*See C. Elton Hinshaw, “The Recognition Pattern of the Federal Open Market Committee,” Rendigs Fels and C. Elton Hinshaw, *Forecasting and Recognizing Business Cycle Turning Points*, National Bureau of Economic Research Studies in Business Cycles No. 17 (New York: Columbia University Press, 1968), pp. 61-128.

**For examples of the professional disputes about fiscal and monetary indicators respectively, see Michael E. Levy, *Fiscal Policy, Cycles and Growth*, The Conference Board Studies in Business Economics No. 81 (New York: National Industrial Conference Board, Inc., 1963), and Karl Brunner, ed., *Targets and Indicators of Monetary Policy* (San Francisco: Chandler Publishing Company, 1969). Policy lags are discussed in Mark H. Willes, “Lags in Monetary and Fiscal Policy,” *Business Review of the Federal Reserve Bank of Philadelphia*, March 1968, pp. 3-10.

***For an explanation of the information value of using some other aggregates, see Myron B. Slovin, “On the Relationship among Monetary Aggregates,” *Journal of Money, Credit and Banking* 6 (1974): 353.

Of course, before getting too deep into the numbers, it's important to review what some economists think may cause economic fluctuations.

Causes of Slowdowns: Tough to Isolate. One explanation of business cycles popular since the 1930s suggests that the economy is inherently unstable. This means that the economy, if left alone, will move along a path of positive growth on average but is likely to experience ups and downs along the way. This inherent instability of the economic system produces something like the following scenario. Consumers and businessmen *allegedly* spend rapidly for a period, then slow their purchasing for a while. Next, adjustments in inventories play a critical role. Optimistic businessmen overstock during prosperous times, but when spending slows, they're caught with too many goods on hand. So, to avoid mounting inventories, businesses curtail production and lay off workers; current sales are met out of existing stocks of merchandise. The laid-off workers buy fewer goods, inventories rise still further, and another round of layoffs ensues. The process repeats itself and what starts off as a mild slowdown tailspins into a recession.

Government stabilization efforts are supposed to moderate the downward spiral by offsetting the downswing in private demand. Increasing Government spending and/or cutting taxes to spur consumer and business spending would be the standard fiscal policy response. Either of these actions would shrink a Federal budget surplus or would widen an existing deficit. Increasing the growth of the money stock would be an appropriate monetary policy response. This would stimulate spending by initially lowering interest rates and increasing wealth.²

²The increasing wealth can come about as the fall of interest rates raises the price of assets yielding fixed incomes (bonds) or through the increased money balances themselves. For further development, see Laurence H. Meyer, "Wealth Effects and the Effectiveness of Monetary and Fiscal Policies," *Journal of Money, Credit and Banking* 6 (1974): 481.

However, not all students of business cycles see the policy choices and their consequences in such a neat scenario. First, some argue that the economy is more inherently stable than implied in this scenario. Second, they believe Government actions in practice tend more often to aggravate rather than moderate slowdowns in economic activity. In their view, Government does not set out to do mischief, but policymakers simply don't know enough about the economy to do more good than harm, or policymakers may have other goals in mind than smoothing out business cycles.

Destabilizing changes in Government policy could occur, for example, because of ignorance about the timing and magnitude of the effects created by policy changes. For example, how much of a tax cut will people spend and when? Alternatively, destabilizing changes might result from Government responding to another problem, such as a high inflation rate. A tax cut may stimulate the economy, but it could also stimulate inflation, for instance. Thus, some business cycle scholars caution against using Government policy to "fine tune" the economy because they think too little is really known about how Government stabilization policies impact on the economy.

HAS STABILIZATION POLICY WORKED?

Applying statistical analysis to business fluctuations cannot *prove* the effectiveness (or lack of effectiveness) of Government stabilization policies in cushioning business slowdowns, but it can provide some clues.³ Clearly, stabilization policy has *not* prevented observed slowdowns. But have policy changes occurred (for whatever reason) which discouraged slowdowns from snowballing into recessions? Or, have restrictive policy moves aggravated slowdowns?

³The tests here involve the thrust of policy and do not necessarily represent the actual desires of policymakers. (See Box 1 for the ingredients of an evaluation of policy decisions).

Congressional Decision-Making: Fiscal Policy. The simplest notion of fiscal policy is that the Federal deficit should be enlarged during slowdowns either by lowering taxes, raising expenditures, or a combination of both.⁴ Unfortunately, to look simply at changes in the size of the standard deficit as a measure of policymakers' response to a slowdown can be misleading. The reason is that the size of the budget deficit can change during a slowdown either *automatically* or because of conscious decisions by policymakers to increase spending programs or to lower tax rates. Revenues, for example, will automatically decline during slowdowns because, among other reasons, corporate profits slip and thus corporate income taxes diminish. Similarly, there are automatic increases in expenditures—unemployment compensation payments, for example, which rise during slowdowns. These passive or automatic changes in spending and revenues have to be filtered out to isolate the conscious or active changes in policy, like a tax cut, that are made to cushion downturns.

The "high-employment" surplus or deficit attempts to isolate policy actions which are independent of the current state of the economy.⁵ To do this both spending and revenue are adjusted to the levels that would have resulted if the unemployment rate hovered around 4 percent—sometimes referred to as the high-employment level. To the extent this adjustment is successful, increases in the high-employment budget deficit or decreases in its surplus mean that fiscal policy is stimulating the economy with more than just the use of economic stabilizers. The Government is increasing overall demand for goods and services

through a new spending program or making more income available for others to spend by way of tax-rate reductions. If such a policy is well-timed, it could offset a slowdown in economic activity. The opposite is also true. A high-employment budget deficit that has shrunk or a surplus that has increased means that Government fiscal policies are becoming more restrictive and reducing overall demand. During a slowdown, this would aggravate rather than alleviate the downturn.

Not all economists are convinced that fiscal policy changes affect the economy immediately, but many believe that the lags are quite short. It is estimated that a substantial part, say at a minimum 30 percent, of the total effect occurs within three months of the policy change.⁶ If so, then sorting out the influence of fiscal policy on slowdowns should be done with data from the same time periods as the slowdowns themselves. Such a comparison is shown in Table 1. The comparison suggests that Government policy, as reflected by changes in the high-employment budget, was on net injecting purchasing power into the spending stream during the three mild slowdowns. However, during the slowdowns which became recessions, changes in the high-employment budget indicate that fiscal policy was a drain on the economy.

The record in dealing with slowdowns is mixed and overall does not deserve high marks. Of the seven slowdowns observed, fiscal policy changed in the "right" direction only three times. During the other four slowdowns, fiscal policy changed either in the "wrong" direction or hardly at all. Of course, looking at slowdowns alone cannot tell us whether fiscal policy prevented some slowdowns which otherwise would have occurred. But, a reasonable conclusion from all

⁴For empirical estimates of these effects in light of concurrent monetary policy, see Nariman Behravesh and Donald L. Raiff, "Tax Cuts Seem Like a Good Idea. . . But How You Finance Them Makes a Difference," *Business Review of the Federal Reserve Bank of Philadelphia*, forthcoming.

⁵For an explanation of the general concept and further references, see Keith Carlson, "Estimates of the High-Employment Budget, 1947-1967," *Review of the Federal Reserve Bank of St. Louis*, June 1967, pp. 6-14.

⁶For an estimate of the lags involved with expansionary policy within the original FRB-MIT model, see Frank deLeeuw and Edward M. Gramlich, "The Channels of Monetary Policy," *Federal Reserve Bulletin* 55 (1969): 472. It shows that 75 percent of the maximum response in real GNP from an expenditure increase and 25 percent of the response from a tax rate cut occur within one quarter after the respective policy actions.

TABLE 1
DURING RECESSIONS FISCAL POLICY HAS NOT CHANGED
TO STIMULATE AGGREGATE DEMAND

Net Injection (+) or Drain (-) on the Economy by
 Changes in the Budget Position during the Slowdowns*

	Slowdowns (Ordered by Severity With Mildest Last)	Standard Budget** (Billions of Dollars)	High-Employment Budget*** (Billions of Dollars)
R E C E S S I O N S	2/57-5/58	+ 6.6	- .1
	2/60-2/61	- 3.0	- 5.1
	3/53-9/54	+ 2.5	- 1.1
	6/69-12/70	+ 7.7	- 5.2
	5/51-7/52	+ 18.8	+ 13.9
	4/62-4/63	- .8	+ 1.8
	6/66-10/67	+ 8.7	+ 7.4

*Measured by subtracting the average budget position during the slowdown from the levels averaged over the two quarters before the slowdown (see Appendix Table B for support data). Because of the way the changes were computed, a positive number means that fiscal policy is moving in the right direction to offset a slowdown and vice versa. For example, during the 1951-52 slowdown, the average level of the high-employment budget surplus declined from \$11.1 billion to an average deficit of \$2.8 billion—a stimulative shift in the budget position of \$13.9 billion.

**Budget numbers are usually presented on a Unified Budget basis or in terms of the National Income Accounts; the standard budget numbers are on a National Income Accounts basis.

***Using four rather than two quarters before the slowdown does not alter the general implications except for the 1953-54 slowdown where the change in the budget position becomes +1.1 percentage points.

of this is that fiscal policy has been largely “hit or miss” in mitigating economic slowdowns—sometimes stabilizing, sometimes destabilizing, and sometimes “neutral.”

Congressional Delegation: Monetary Policy. Congress does not make the decisions involving discretionary monetary policy. Through the Federal Reserve Act and subsequent amendments Congress has delegated this power to the Federal Reserve System. The

Fed’s power to implement monetary policy is based on its ability to “control” (see Box 2) the U.S. money stock (the public’s currency and checking account balances). Changes in the rate of growth for money can be viewed as an indicator of discretionary monetary policy changes. While this is not the only measure of monetary policy, it is commonly used by analysts.

Theoretical and empirical studies have

BOX 2

HOW THE FED CONTROLS THE MONEY STOCK

In the United States, the Federal Government and the commercial banks are the issuers of money (currency plus demand and, possibly, time deposits at commercial banks*). However, the Federal Reserve System, an agency of the Federal Government, has the responsibility for controlling the money supply. The Fed exercises control through its own liabilities—currency and reserves of member banks (so-called high-powered money). It is through injecting or withdrawing high-powered money into or from the economy that the money supply is changed.

Changing High-Powered Money. There are two methods the Fed uses to alter the amount of high-powered money in the economy. By far the most important of these is the use of “Open Market operations.” Using this method the Fed buys or sells (U.S. Government) securities in the financial marketplace. When securities are bought, the sellers (individuals, corporations, and security dealers) receive payments in dollars which they either hold as currency or deposits in the bank. When securities are sold, the buyer usually pays by check and the Fed debits the reserve account of the bank on which the check was drawn. A second significant but far less important method is directly making loans to banks. Again, however, the Fed has the ultimate power to limit how much it will lend.

Changes in High-Powered Money Change the Money Supply. Adding high-powered money to individuals’ currency holdings directly adds to the money stock. However, since individuals and businesses keep only a small part of their total money holdings in currency form (about a fourth), most of the high-powered money goes into reserves in the commercial banks. With an increase in reserves, a bank is able to increase its checking (or savings) account liabilities—in part by crediting the account of the depositor of high-powered money and in part by making more loans and, hence, crediting the borrower’s account by the amount of the loan. Thus, by changing banks’ reserves, the money supply is also changed. In fact, since banks keep less than a dollar in reserves for every dollar of deposits issued, a change in bank reserves of a dollar results in a change in deposits and, hence the money stock, of more than one dollar.

The Fed’s control over the money stock is by no means absolute, especially within the space of a month or even one to two quarters. For example, the Fed cannot be sure exactly how much the money stock will change every time it puts in or takes out a given amount of high-powered money. Nonetheless, as long as the Fed controls the reserve base, the relationship is fairly predictable over several quarters, and over the space of, say, six months, Fed actions become the major determinant of changes in the money stock.

*The criterion for including time deposits in the money supply is whether individuals regard this asset as a close substitute for assets accepted as a means of payment—that is, for currency or demand deposits. For policy matters, current practice is often to consider both the narrower and more inclusive definition. Because movements in the money stock according to one definition tend to parallel movements according to the other, the use of either definition usually leads to similar policy implications or conclusions.

suggested that people get used to the growth rate in money over the long haul.⁷ To make a long story short, the past record of money growth gets built into current and future inflation rates, interest rates, and spending patterns. However, if there are substantial deviations (that is, lasting six months or so) from the recent experiences in terms of money growth, individuals and firms will be surprised and adjust accordingly. For example, if for six months the growth rate for money exceeds what people have become accustomed to, economic activity (either in terms of output, inflation, or both) would tend to speed up. This occurs as people and firms increase spending and investment in financial assets as a response to their higher than previously anticipated balances of money. Thus, if monetary policy is to be used to offset slowdowns, the money growth rate should increase to offset a weakening economy. Conversely, downward movements in money growth would represent a policy which exacerbates a weakening of economic activity.

The actual time between monetary policy shifts and the impact of those changes on economic activity is not known with certainty. If the time-lags were quite short, isolating the influence of monetary policy on slowdowns could be accomplished with data from the same periods as the slowdowns themselves.⁸ Then the time periods used in the analysis would be similar to those used for testing fiscal policy. However, economists have made

⁷For example, see Milton Friedman and Anna J. Schwartz, "Money and Business Cycles," *Review of Economics and Statistics* 45, Part 2 supplement (1963): 32-64, as well as Friedman's recent summary, "Rediscovery of Money: A Discussion," *American Economic Review* 65 (1975): 176-79.

⁸Some economists would argue that this concurrent measure does not signal the thrust of policy since the money stock growth might be dominated by a declining demand and not reflect supply changes. Others would argue, just as ardently, that the end result is still important. If the Fed allows money growth to slow relative to established averages, it is accepting the depressing effects on economic activity (although perhaps out of unwillingness to alter credit market conditions).

a case for using longer time-lags in analyzing the effects of changing monetary policy. If monetary policy takes between two and three quarters to alter the course of economic activity substantially (for example, 30 percent of the total effect),⁹ it would be necessary to compare the growth rate of the money stock before the slowdown with its longer term average rate of growth.

Going into the milder slowdowns, money-stock growth increased relative to the long-term average rate of growth (see Table 2). However, this wasn't true prior to the recessions. A decline in the growth rate of money preceded each of these periods. Three of these four decelerations were substantial. Similar judgments about money growth also emerge from studying changes in the growth rate of money *during* the slowdowns.

Using the growth rate change just before the slowdowns as the main criterion, monetary policy, like fiscal policy, appears to have a mixed record between 1950 and 1970. Growth in the money stock rose substantially before only two of the seven slowdowns. Of the other five slowdowns of which four turned into recessions, money growth slowed appreciably in three and changed little in two.

From these observations alone, it would be difficult to blame every recession on monetary policy. Nonetheless, these data along with other more sophisticated forms of analysis provide the backdrop for concern that slowdowns in money-stock growth can happen at the wrong time with destabilizing effects on economic activity.¹⁰ Of course,

⁹The original FRB-MIT model showed 30 percent of the maximum response in real GNP from a change in bank reserves occurs over the first three quarters. See de Leeuw and Gramlich, "The Channels of Monetary Policy," pp. 472-91.

¹⁰For some references and a recent study which searches to see if deceleration in money-stock growth is both necessary and sufficient for the occurrence of a recession, see William Poole, "The Relationship of Monetary Decelerations of Business Cycle Peaks: Another Look at the Evidence," *Journal of Finance* 30 (1974): 697.

TABLE 2
THE MONETARY GROWTH RATE
HAS TYPICALLY DECELERATED PRIOR TO RECESSIONS

Net Injection (+) or Drain (-) on the Economy
 By Changes in the Growth Rate of Money (M_1)*

	Growth Slowdowns (Ordered by Severity With the Mildest Last)	During Slowdowns** (Percentage Points)	Before Slowdowns*** (Percentage Points)
R E C E S S I O N S	2/57-5/58	- 1.5	- .3
	2/60-2/61	- 1.3	- 4.9
	3/53-9/54	- 3.4	- 2.4
	6/69-12/70	- 2.7	- 2.5
	5/51-7/52	+ 3.4	+ 2.2
	4/62-4/63	+ .5	+ 1.3
	6/66-10/67	- .3	+ .1

* M_1 is demand deposits plus currency in the hands of the public. Using a broader measure of money, M_2 (M_1 plus time deposits at commercial banks) in the "before slowdown" calculation, changes the general implications for only the extremes in slowdowns: 1957-58 is preceded by an increase in M_2 growth by .9 percentage point and 1966-67 is preceded by a decline in M_2 growth of 1 percentage point.

**Measured by subtracting the growth rate (annual basis) over 24 months ending six months before the slowdown from the growth rate (annual basis) occurring during the slowdown period (see Appendix Table C for support data).

***Measured by subtracting the growth rate (annual basis) over the 24 months ending six months before the slowdown from the growth rate (annual basis) occurring before the slowdown period (see Appendix Table C for support data).

monetary authorities may have been focusing on goals other than offsetting slowdowns, like fighting inflation. Also monetary policymakers may have been looking at other policy targets such as interest rates rather than the money stock.

THE LATEST SLOWDOWN: A TWO-PART SCENARIO

Going into 1974, many forecasters saw a

period of continuing slow growth. Economic activity was supposed to show an average growth rate of 1.2 percent with declines in the first half offset by growth in the second half.¹¹ Actually, the economy posted a 2.2-percent decline, with business deteriorating in varying degrees throughout the year. Instead of a

¹¹*Business Forecasts 1974*, Federal Reserve Bank of Richmond, February 1974.

short, shallow downturn, the economy kept slipping. What happened?

What happened was an unusual sequence of events—a two-part scenario.¹² During the

¹²For further development of this idea, see N. Bowsher, "Two Stages to the Current Recession," *Review of the Federal Reserve Bank of St. Louis*, June 1975, pp. 2-8. For a longer cycle approach, see Arthur F. Burns, "The Current Recession in Perspective," *Economic Review of the Federal Reserve Bank of Richmond*, May/June 1975, pp. 2-7.

first part, from July 1973 through October 1974, *supply* constraints dominated the slump. Shortages related to price controls and the oil embargo dominated the supply problem. Not until November 1974 did the economy begin to resemble past recessions with weakening *demand*. (See Box 3.) By this time the slowdown was also being given a further downward shove by restrictive Government policies.

Slowdown... In mid-1973, the economy was

BOX 3

WHEN IS A RECESSION THE REAL THING?

The National Bureau of Economic Research has long used a rather flexible procedure in deciding upon the reference dates for contractions and expansions.* Deciding whether or not we have had a recession requires more than just scanning the rates of change in any one economic series. In its concern to study the amplitude, duration, and scope of past business cycles, the NBER staff has assembled lists of business indicators to watch. However, there has been no assumption that each variable should have a fixed weight in decisions or that the current list will not be added to next time.

In an effort to improve the list of indicators, diffusion indices are becoming more important to the NBER's efforts. These indices indicate the percentage of expanding firms. For example, a value of 75 for the diffusion index on industrial production means that 75 percent of the industries covered are expanding output this period.

Despite the availability of diffusion indices and other indicators, many financial writers called the current period a recession on the basis of a simple rule of thumb involving only one economic variable—real GNP. The rule implies that if two quarters of negative movement in real GNP occur, we have been through part of an "official" NBER recession.

The "official" NBER pronouncement has supported this rule of thumb by dating the peak at November 1973. However, one could argue that the current slowdown only qualified as a recession after the downturn worsened at the end of 1974.** Yet this worsened portion of the downturn is three to six months after the rule of thumb implied that we were in a recession. As such, this rule of thumb may not prove to be an adequate measure in the future.

*See Geoffrey H. Moore, "What Is a Recession?" *American Statistician* 21 (1967): 16, for a good layout of current procedures in dating peaks and troughs. Attempts at making the procedure more mechanical can be found in Ilse Mintz, "Dating United States Growth Cycles," *Explorations in Economic Research* 1 (1974): 1-113; and Gerhard Bry and Charlotte Boschan, eds., *Cyclical Analysis of Time Series*, National Bureau of Economic Research, Technical Paper No. 20 (New York: Columbia University Press, 1971).

**For example, see Geoffrey H. Moore, "Recession?" *Economic Outlook USA*, Summer 1974, pp. 4-5.

slowing down, following the rapid real growth experienced over the previous six months. During the first half of 1973 money-stock growth was around 7 percent—as it had been on average for about two years—and fiscal policy was still in deficit on a full-employment basis, although moving toward a surplus. Forecasters were predicting that late 1973 and 1974 would provide a breathing spell from rapid growth. The only sector expected to be strong was business investment, which would enlarge the nation's capacity to produce and possibly relieve some of the inflationary pressure. As late 1973 arrived, the economy was hit with an oil embargo by members of the Organization of Arab Petroleum Exporting Countries (OAPEC). In early '74 members of a different but similar group—the Organization of Petroleum Exporting Countries (OPEC)—hiked the price of their oil markedly. This cutback in supply fueled additional increases in the inflation rate and sparked a series of economic adjustments away from petroleum-intensive activities.

Economists expected—once they incorporated the magnitude of OPEC plans into their forecasts—that energy-intensive industries would suffer and others would benefit. The net effect of this kind of adjustment turned out to be a decline in total output in the first half of '74. As the economy moved through this period of industry-by-industry adjustment to a new supply situation for energy, Government policy became restrictive.

Then Recession. Ostensibly to curb the rapid inflation, fiscal policy tightened from a slight high-employment surplus of \$3 billion averaged over mid-1973 (second and third

quarters) to a surplus of \$10.7 billion averaged over 1974. Money-stock growth slowed from its two-year average of around 7 percent to a level slightly below 4 percent from April through October 1974. With these Government policy changes, the latter part of 1974 witnessed an economy taking on the characteristics of past recessions. An unusual supply-induced slowdown had become the typical demand-deficient downturn. The slowdown turned into a severe recession, encouraged by a restrictive shift in Government policy.

A RECAP

The thrust of stabilization policy which accompanied economic slowdowns between 1950 and 1970 can be analyzed with some simple tests. According to these tests, the record for monetary and fiscal policy, in terms of mitigating slowdowns in the economy, has been spotty at best. True, some slowdowns—those remaining mild—were aided by policy thrusts which provided “net injections” to economic activity. But, the slowdowns that became recessions were aggravated by policy thrusts which placed drains on the economy. Possibly these “drains” upon real growth resulted from policymakers pursuing goals other than maintaining high levels of steady economic growth. This seems to have been the case in 1974, when policymakers (in an attempt to combat double-digit inflation) responded with restrictive policies. On balance, the Government's success in executing fiscal and monetary policies to smooth out business slowdowns appears to be a long way from fulfilling the dream of steady growth.

APPENDIX
TABLE A
DATES FOR SLOWDOWNS AND RECESSIONS: SINCE 1950*

Growth Downturn		Reference Peak		Reference Trough		Growth Upturn		Occurrence Of Growth Slowdown and a Recession	Percent Change In Real GNP From Downturn To Upturn Quarter	Severity Ranking**
May	1951					July	1952		+ 3.3	5
March	1953	July	1953	May	1954	September	1954	Yes	- 1.2	3
February	1957	August	1957	April	1958	May	1958	Yes	- 3.1	1
February	1960	April	1960	February	1961	February	1961	Yes	- 1.6	2
April	1962					April	1963		+ 3.5	6
June	1966					October	1967		+ 4.4	7
June	1969	December	1969	November	1970	December	1970	Yes	- .9	4
July	1973	November	1973***	June	1975			Yes	N/C	N/C

*Growth cycle dates through 1973 correspond to those set in Ilse Mintz, "Dating United States Growth Cycles," *Explorations in Economic Research* 1 (1974): 67, table 10, 12 indicators--undeflated. Peak and trough dates through 1970 are the new series announced in *Business Conditions Digest*, May 1975.

**The measure chosen for severity is the percent change in real Gross National Product--current output adjusted for price changes since 1958. The 1974-75 experience is treated separately from earlier slowdowns because data from the entire recessionary period is not yet available. Also it allows us to save this observation as a "test" for the implications drawn from earlier periods. N/C--complete data for the period not available.

***The analysis in the text is based on the assumption that the economy began to resemble past recessions, starting in November 1974.

APPENDIX
TABLE B
DATA FOR THE FISCAL POLICY EVALUATION
(BILLIONS OF DOLLARS—ANNUAL RATE)
[Surplus (+) or Deficit (-) Position]

		National Income Accounts Budget		High-Employment Budget	
Slowdowns (Ordered by Severity With Mildest Last)		Average over Two Quarters Before Slowdown	Average during Slowdown*	Average over Two Quarters Before Slowdown	Average during Slowdown*
R E C E S S I O N S	2/57-5/58	+ 5.5	- 1.1	+ 6.7	+ 6.8
	2/60-2/61	- .8	+ 2.2	+ 9.5	+ 14.6
	3/53-9/54	- 5.7	- 8.2	- 6.8	- 5.7
	6/69-12/70	+ 4.2	- 3.5	+ 4.9	+ 10.1
	5/51-7/52	+ 17.6	- 1.2	+ 11.1	- 2.8
	4/62-4/63	- 3.5	- 2.7	+ 11.1	+ 9.3
	6/66-10/67	+ .2	- 8.5	- 1.5	- 8.9

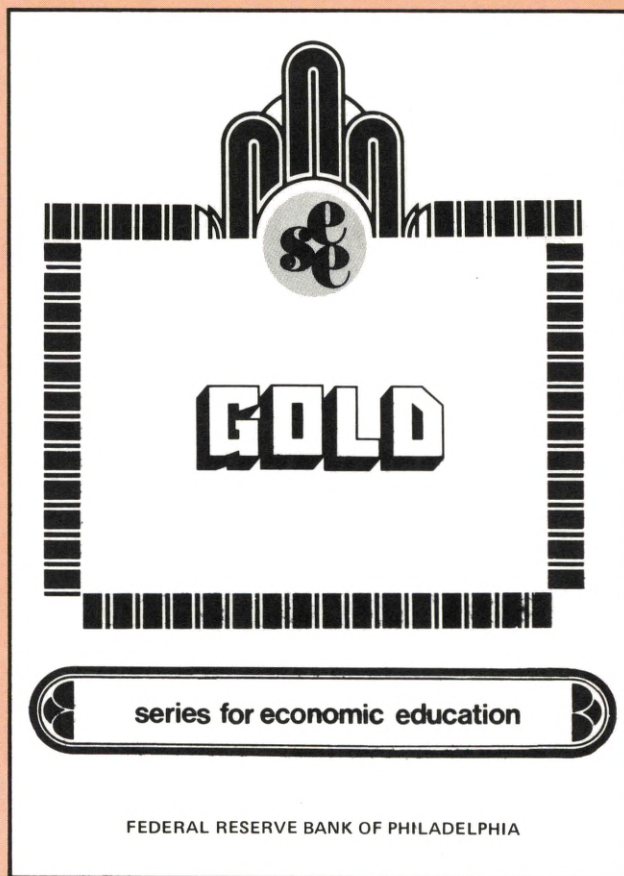
SOURCE: Federal Reserve Bank of St. Louis.

*Excludes beginning and ending quarters of each slowdown because they may be only partially within the slowdown period.

APPENDIX
TABLE C
DATA FOR THE MONETARY POLICY EVALUATION
(GROWTH RATE IN M_1 —ANNUAL BASIS)

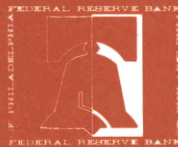
	Growth Slowdowns (Ordered by Severity With Mildest Last)	Two Years Ending Six Months Before Slowdown	Six Months Before Slowdown	During Slowdown
RECESSIONS	2/57-5/58	1.9%	1.6%	.4%
	2/60-2/61	2.7	- 2.2	1.4
	3/53-9/54	4.9	2.5	1.5
	6/69-12/70	7.5	5.0	4.8
	5/51-7/52	1.8	4.0	5.2
	4/62-4/63	1.4	2.7	1.9
	6/66-10/67	4.7	4.8	4.4

SOURCE: *Federal Reserve Bulletin.*



On December 31, 1974, Americans were permitted to buy and sell gold for the first time in some 40 years. Since then questions have been raised about the once-hallowed, almighty metal's worth and importance. For example, has its status in the United States and in the international monetary system changed? If so, in what manner? A pamphlet recently produced by the Philadelphia Fed's Department of Public Information considers the role of gold—past, present, future.

Copies are available free of charge. Please address all requests to Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, PA 19105.



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