

THE EFFECTS OF FEDERAL RESERVE POLICIES

BASIC ISSUES OF MONETARY POLICY

BY

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Introduction:

A. Previous speakers emphasized two related aspects of all analysis

1. The "Inevitabilities" - necessities

a. IF you do thus and so then SOMETHING ELSE MUST happen  
e.g. If F.R.S. buys Governments, then other Reserve  
Bank accounts must change so that books remain  
in balance.

If Treasury sells long bonds, somebody must  
buy them - and he cannot use that money to buy  
something else.

Changes in taxes have economic effects

b. This is so simple we take it for granted - but we  
also forget and act as though it were not true.

2. The elements of judgment - as related to the Federal  
Reserve System

a. As to what the something else will be in fact  
e.g. which other F.R.B. accounts will change

b. As to what the Federal Reserve System should try  
to accomplish - objectives of policy

c. As to how the System should try to accomplish its  
goals - instruments of policy

d. As to the organization of the System

(Once you make the choice you must pay the cost.  
To will the end is to will the means.)

B. Why have a Federal Reserve System?

- 1. Glib talk about letting money manage itself
- 2. Kemmerer's study for the N.M.C.
  - a. Average call money rates 1890-1908 (19 years)
    - 1st week in June 2.28%
    - Last week in Dec. 7.38%
  - b. 1907
    - Average call rate for June 1-3/4%
    - On Thursday, Oct. 24 125%
- 3. One reason for creating System was to provide an elastic currency
- 4. But that is monetary management

C. The Power of the System

- 1. To withdraw money
  - \$25 billion of earning assets
  - ( M=\$30
  - ( Member bank reserves
  - ( <\$20 bill.
- 2. To add money
  - a. Free gold to buy \$38 billion
  - b. Reserve requirements of members above legal minimum \$ 8 billion
- 3. To what purpose should these powers be used, since the System doesn't operate for profit?
  - To promote stable economic progress - but that is pretty vague

I. Objectives of Federal Reserve Policy

- A. number of attractive objectives
- A. Specific objectives and related programs of action
- B. The possibility of conflict and the inevitability of choice - conscious or otherwise
  - Combination
  - Changing emphasis over time

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<b>III A. <u>Objectives and Related Programs</u></b>		
<b>Objective</b>	<b>Conditions calling for or permitting an easing of credit</b>	<b>Conditions calling for or permitting a tightening of credit</b>
<b>1. Convertibility</b>	<b>High and/or rising primary reserves</b>	<b>Low and/or declining primary reserves</b>
<b>2. Productive credit</b>	<b>Increase in monetary volume of output</b>	<b>Decrease in monetary volume of output</b>
<b>3. Stable price level</b>	<b>Declining prices</b>	<b>Rising prices</b>
<b>4. Full employment</b>	<b>Less than full employment</b>	<b>Jobs in excess of workers</b>
<b>5. A fixed rate of interest</b>	<b>When savings are inadequate</b>	<b>When savings are excessive</b>

We have an excellent current illustration of problem of choice among objectives

	<del>March 10,</del> June 9, 1954	<del>March 11,</del> June 10, 1953	Differ.	Dec. 31, 1952	Differ.
1) Monetary gold stock	<del>21,924</del> 21,963	<del>22,537</del> 22,611	<del>-613</del> -648	23,187	<del>-1,263</del> -1,224

TIGHTEN CREDIT?

	Latest	In last year		1947-1949 = 100	
		Max.	-	Min.	
2) Prices					
a) Consumer	<del>Jan. 115.2</del> Apr. 114.6	115.4		113.7	<del>Jan. 1953 113.9</del> Apr. 113.7
b) Wholesale	<del>Mar. 2 110.6</del> June 1 110.8	111.0		109.3	<del>Mar. 3, 1953 109.9</del> June 2 109.7

LEAVE ALONE - over whole year?

	<del>February</del> May 1954 1954	<del>1953</del>	<del>April 1954</del> 1954	<del>1954</del>	<del>May 1953</del> Old Series	
3) Unemployment:						
Total labor force	<del>66,400</del>	67,780	<del>67,139</del>	67,438	66,905	66,497
Civilian labor force	<del>62,850</del>	64,424	<del>63,725</del>	64,063	63,491	62,944
Employed - total	<del>61,050</del>	61,119	<del>60,046</del>	60,598	60,106	61,458
Non-agricultural	<del>55,400</del>	57,300	<del>54,349</del>	54,522	54,480	55,068
Agricultural	<del>5,650</del>	6,800	<del>5,697</del>	6,076	5,626	6,390
Unemployed - total	<del>1,800</del>	3,205	<del>3,671</del>	3,465	3,385	1,306
% of civilian labor force	<del>2.9</del>	5.1	<del>5.8</del>	5.4	5.3	2.1

EASE?

(Unemployment down from 1.9 in January to 1.3 in May)

(pencil figures are for later dates)

## II. The Means of Accomplishing Objectives

- A. You want to keep our markets for consumption and investment in balance with production at high levels.
- B. By influencing credit conditions or the TONE of the money and capital markets
  - 1. Supply of money and credit
  - 2. Availability - mortgage money last May and June!
  - 3. Demand for credit
  - 4. Price of credit or interest rates

## III. Instruments of Policy

### A. Types

- 1. General - or "quantitative"  
affect supply, availability and cost - and demand
- 2. Selective - or "qualitative"  
relate to particular types

Limit demand by requiring prospective borrower to meet specified conditions

### B. Analysis of General Controls

- 1. Discount rate and administration
  - a. Appropriate and inappropriate uses.  
Difference of opinion on relative weight to cost and rules  
Martin's Boston speech
  - b. Limits to effectiveness of rate
    - (1) To control expansion:  
when no one is borrowing  
high rate can't reduce
    - (2) To induce expansion  
when no attractive loan and  
investment opportunities are available

2. Open market operations

a. Developed to overcome defects of the rate

- (1) To control expansion  
- "making rate effective" by forcing market into central bank
- (2) To induce expansion  
- make funds freely available ,  
supply more liquidity than the market wants

b. Limits to effectiveness of open market operations

(1) To control expansion

Portfolio of Government securities

e.g.	Excess reserves	Portfolio
Dec. 1935	\$3.3 bil.	\$2.4 bil.
Nov. 1940	6.9 "	2.2 "

(2) To induce expansion  
eligible assets in market  
authority to buy - now \$38 billion

Can't push on a string - severe depression

(This led to idea of compensatory fiscal policy -  
but that is another topic that I shall not discuss.)

3. Changes in Reserve Requirements  
- first suggested in 1917

a. Affects all members directly rather than  
through money market

b. Limits

on authority to change

on effectiveness

- contingent on willingness to see  
"tone" of market change

- pushing on string

4. Interrelations of instruments

Sale of securities may force banks to borrow  
Their attempts to repay will be reflected in reduced  
availability of credit and higher rates.

Change in reserve requirements not very effective  
unless allowed to affect tone and terms in credit  
market. (We still have much to learn about this.)

But 1% = \$1 billion - may offset part to prevent  
sudden spasm of tightness or sloppiness

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C. Analysis of selective controls

1. Margin requirements
2. Consumer credit regulation
3. Real estate credit regulation
4. Other?

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D. A basic issue of monetary policy - relative  
importance of general and selective

1. Extreme for general - *Chicago* -
2. Extreme for selective - *Keplerling* *Clark* - *risk too great to use general*
3. In between

IV. Other Basic Issues of Monetary Policy

A. The role of interest rates

1. Level should be of no concern  
- Chicago
2. Should be kept low  
- Keyserling, Clark
3. Variable but controlled to suit economic development

B. How useful can monetary policy be?

1. Can do everything  
Chicago  
Clark Warburton ) F.D.I.C.  
Edison Cramer )
2. Can do nothing - too great a risk
3. Necessary but not sufficient

Council of Economic Advisers' view on cheap credit

(Hearings - January 1950 Economic Report - 1/17-20/50, p. 68)

The value of cheap credit. - The difference in our position from that of the subcommittee arises in part from a somewhat different view of the desirability of low interest rates. In the report of the subcommittee it is said, and repeated, that low interest rates are generally beneficial, but it is proposed to yield that principle in periods of inflation and to use central bank operations to induce an increase in the cost of money.

Our view is that low interest rates are always desirable. In periods of inflation they have the undesirable collateral consequence of contributing to inflationary forces, but even then they have the economic advantage of facilitating the expansion of productive capacity which is the best road to stability. Where we differ with the subcommittee is that we would not abandon the advantages of cheap money and use central bank operations to cause an anti-inflationary increase in interest rates. We would retain the advantages of cheap money and adopt other measures to curb the inflationary forces. In extreme cases, as in 1947-48, we would tighten the availability of credit by pressure upon bank reserves under the plan proposed by the Federal Reserve Board at that time, but would hold the resulting trend to higher interest rates within narrow limits.



C. Organization of System

1. Relation to Government: Treasury
2. Centralization vs. decentralization
3. On differences of opinion within the System
4. On errors in judgment -
  - a. Looking back
  - b. Looking forward

(Do not expect perfection in a human institution.)

D. Suggestions

1. Follow the statistics
2. Follow official statements
3. Follow reports

Principles of War, General von Clausewitz

"The conduct of war resembles the workings of an intricate machine with tremendous friction, so that combinations which are easily planned on paper can be executed only with great effort."

"The results on which we count are never as precise as is imagined by someone who has not carefully observed a money market and become used to it."

Qualities every student tries to achieve

Technical competence

- to recognize and always take into account - become part of our thinking: THE NECESSITIES

Improved judgment with experience

Courage and enthusiasm

Humility