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KRB

NOTES

Conference of Chairmen and Deputy Chairmen
of the Federal Reserve Banks

December 5-6, 1957

Board of Governors, Washington, D. C.

Thursday, December 5 - 11:15 am

Pros and Cons of Tight Money Policy

Introduction

(1) Participate with you in discussion of the pros and cons of tight money policy

(2) Near term problem may be how to cope with recession
- but problem of inflation will likely recur
- a good time to reappraise our experience

(3) Method of discussion

(a) Desire a maximum of participation

(b) Instead of having me give a formal 15-20 minute talk on the views of critics followed by similar talks on the other side by Win and Woody,

(c) I shall develop a specific argument of the critics and then ask all of you to join in an evaluation of the argument.

Then move on to a second argument, covering as many as we can in an hour

(d) You appreciate the position I am in

(i) I shall develop argument as cogently as I can

(ii) Advantage - like arguing for tariff
What is evident vs. what lies beneath

(e) Devil's advocate - not interested in winning argument but in understanding

I. The tight money policy has failed

A. As money became tighter - finally interest rates reaching the highest levels in more than 20 years! -

1. The cost of living moved up inexorably, the erosion of the dollar continued

a. And the rise would have been greater, except for an extremely depressed agriculture!

2. We experienced the greatest investment boom in all our history. It was not prevented by tight money

a. Because it was financed largely from internal funds

(1) Depreciation

(2) Retained earnings

b. Because 52% corporation tax rate meant the corporation paid less than 1/2 the increase in interest costs

B. The investment boom now seems to be slowing down

BUT tight money cannot be given the credit - on the contrary it must take the blame!

1. Businesses had been all enthused about the capacity needed for 1965!

Then began to realize that is still 7-8 years off and they had too much capacity for 1958!

Lead	Autos
Zinc	Household durables
Copper	
Even aluminum	
Oil ?	

By relying on tight money during the boom we sowed the seeds for the present recession

II. The "impersonal" tight money policy is in fact discriminatory against the very segments of the economy that we wish to foster

We are, in fact, choosing to hit these areas when we use a tight money policy

A. Small business

1. Don't have adequate data

BUT

a. Know about business failures

b. General reasoning on who lender would favor
Cite Galbraith

It is all very well to say it separates the men from the boys but that is a harsh way to look at human tragedy.

This is not the group that contributes much, if anything, to inflationary pressures.

B. Housing

We want a nation of homeowners

C. Community projects - we need them

1. Schools

2. Roads

D. Income redistribution

Those of great wealth - the savers - get more

The poor - necessitous borrowers - get less

In short, tight money creates social evils

III. Rising interest rates cause prices to rise

A. Interest is a cost that must be recovered in prices

1. Historical relationship between interest rates and prices

(Analogy of using brake/accelerator on a hilly road)

B. Specific illustration of how they increase cost of living

1. Result in higher taxes because higher rates increase cost of borrowing by

a. Federal Government

b. State governments

c. Local governments
School districts, etc.

2. Utility rates

3. Cost of mortgages - housing

IV. Tight money policy cannot deal with cost/push - as contrasted with demand/pull inflation

A. Our only options are

1. Creeping inflation

2. Unemployment (avoidable!)

V. The prospect of rising interest rates stimulates (it does not limit!) loan demands

Business men operate on anticipations
- Borrow to beat the rise
- Then, having the funds, they spend

VI. Monetary Policy operates on and thru the commercial banks

It has no great influence on non-bank lenders

K. R. Bopp
12/5/57