Research Department
Federal Reserve
Bank of
San Francisco

November 1, 1974

Policy and Equity

Every Administration is necessarily restricted in its choice of programs by the uneven incidence of policy upon various sectors of the economy. It faces a difficult task ensuring that the burden of sacrifice is evenly distributed, so that policy may stay the course until the desired effects are achieved. The task is aggravated by the special nature of today's economic problem, with recession and inflation both occurring simultaneously.

Monetary policy tends to have a more uneven impact than fiscal policy. Sectors which rely heavily on credit flows—home-building in particular—usually bear the brunt of a tightening in monetary policy. Fiscal policy is better able to redistribute the burden of sacrifice, because tax and expenditure policies can be tailored to affect specific sectors of the economy, or to affect individuals and businesses on the basis of their income through the income tax and the withholding mechanism. (As an example, the investment-tax credit can be used either to encourage or discourage plant-equipment spending.) We should not try to impute too much precision to fiscal policy, but still, it generally has an advantage over monetary policy in this regard.

For years, monetary policy has been forced to shoulder the major share of the burden of combatting inflation. However, a restrictive monetary policy sometimes is eased when unemployment worsens, before the policy has had a chance to overcome the inflation it was designed to contain. The basic problem, then, is to come up with a viable program that will minimize disparities in sacrifice so that an anti-inflation program may be followed to its most effective limits. Monetary policy by itself cannot lessen these disparities; it governs the cost and availability of credit and leaves the allocation function to the market, which does not adjust for considerations of interpersonal equity.

Fiscal package

The Administration's fiscal program is centered largely around a $2.5-billion income-tax surcharge, which would help pay the cost of an expanded public-employment program and tax relief for lower-income families. (The latter was not formally proposed in the President's message, but it is implicit in the Ways and Means Committee proposal for an increased low-income allowance.) The employment program would encompass grants-in-aid to local governments to provide 400,000 to 700,000 jobs, depending on the level of unemployment. Fiscal actions of this type, unlike monetary actions, can affect employment in a direct and precise fashion.

The surcharge, despite its undoubted value as an anti-inflation tool, has been criticized as a possible contributor to recession. Real disposable income has declined 3.2

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percent over the past year, and real consumption spending has dropped by a comparable amount. The classical fiscal policy prescription for reducing aggregate demand thus seems ill-suited to what is no longer a demand-pull type of inflation. It should be remembered, however, that the entire fiscal package is designed to have an essentially neutral impact, since the extra revenues induced by the surcharge are already allocated under the program. In other words, the total package is meant to shift a given tax burden without either increasing or decreasing tax revenues.

The Administration program would not only cushion the adverse distributional effects of monetary policy through selective measures, but would also encompass a reduction in the level of government expenditures. This reduction would not counteract the supportive measures already mentioned; it would simply mean a tighter ordering of priorities, with less pressing programs deferred or abandoned. Reductions in defense hardware and construction, and deferrals of certain civilian programs (road construction, home-ownership assistance and airport facilities) could provide savings of roughly $7 billion, and thereby permit the budget to be brought below the proposed $300-billion ceiling. With these cutbacks in spending and in the Federal deficit, the lessened demands upon the credit markets should be reflected in lower interest rates, and consequently in reduced pressure on monetary policy.

Models of restraint

Simulations performed with this bank's econometric model help illustrate what the Administration's program could accomplish, when coupled with a "stay the course" policy of moderate monetary restraint. For contrast, we can compare this with the results obtained from a relatively easy policy aimed principally at the problems of recession and unemployment.

In the first simulation, which assumes a tight rein on Federal spending and a moderately restrictive monetary policy, significant progress would be made against inflation by the end of 1975, but at the cost of a slow turnaround in economic activity and growing unemployment. In the second simulation, which assumes greater ease in both fiscal and monetary policy, progress against inflation would come more slowly, but definite improvement would occur by late 1975 in both real output and unemployment.

Policy choice

At first glance, the policy choice would strongly favor the relatively easy policy. However, this type of prescription could lead to future problems with inflation; after all, our present predicament is a legacy of too much ease in 1968 and again in 1972.

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The proper policy mix would appear to consist of one policy designed to overcome inflation and a second designed to make the anti-inflation fight reasonably equal in terms of social costs. Policymakers in the past have leaned heavily on monetary policy in fighting inflation, but then have been forced to abandon the fight too soon because of the danger of recession. But with fiscal policy used judiciously to redistribute the burden of an anti-inflationary program on a more equitable basis, it is possible to stay with such a policy until it achieves a more lasting effect upon inflation.

There is no question that eliminating an inflation that was a decade in the making is definitely a long-haul problem. Yet the adverse distributional effects may be greatly modified through the use of a reasonable amount of ingenuity in formulating fiscal-policy measures.

Herbert Runyon

Western Highlights

Business loan demand continued rising in September, especially in California. Mortgage loans turned sluggish, however, while security holdings declined. Deposit flows weakened at Western banks during the month . . . Federal Reserve member banks reduced their borrowing at the San Francisco Bank's discount window in September by more than $30 million on a daily average basis. As another sign of decreased restraint, large bank purchases of Fed funds dropped sharply to their lowest point for the year.

Employment increased slightly in the West during August, but lower California figures for September indicate that the regional increase may be shortlived. The August gains occurred in nearly all sectors, with a noticeable increase in construction as workers returned to work after several strikes in the industry. . . . California's unemployment rate jumped from 7.7 to 8.2 percent in September, reflecting the worsening of the state's employment picture. This was in line with a jump in the national rate from 5.4 to 5.8 percent for the same time period.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/16/74	Change from 10/9/74	Change from year ago	
			Dollar	Percent
Loans (gross) adjusted and investments*	83,889	− 897	+8,594	+ 11.41
Loans gross adjusted—	67,381	− 724	+9,572	+ 16.56
Securities loans	1,860	− 770	+ 859	+ 85.81
Commercial and industrial	24,041	− 28	+3,885	+ 19.27
Real estate	19,954	+ 42	+2,197	+ 12.37
Consumer instalment	9,580	+ 19	+ 698	+ 7.86
U.S. Treasury securities	4,100	− 43	−1,313	− 24.26
Other Securities	12,408	− 130	+ 335	+ 2.77
Deposits (less cash items)—total*	81,501	+ 647	+7,678	+ 10.40
Demand deposits adjusted	23,497	+ 589	+1,625	+ 7.43
U.S. Government deposits	358	+ 65	− 237	− 39.83
Time deposits—total*	56,124	− 138	+6,017	+ 12.01
Savings	17,946	+ 30	+ 259	+ 1.46
Other time I.P.C.	28,641	− 85	+5,546	+ 24.01
State and political subdivisions	6,170	− 64	+ 88	+ 1.45
(Large negotiable CD's)	15,111	− 165	+3,566	+ 30.89

Weekly Averages of Daily Figures	Week ended 10/16/74	Week ended 10/9/74	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	102	17r	43
Borrowings	257	63	71
Net free (+) / Net borrowed (−)	− 155	− 46r	− 28
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+) / Net sales (−)	+1,175	+ 760	−173
Transactions: U.S. securities dealers			
Net loans (+) / Net borrowings (−)	+1,585	+1,152	−230

*Includes items not shown separately.

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