Research Department
Federal Reserve
Bank of
San Francisco

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Congressional Reporting

Earlier this year Congress passed a joint resolution, H. Con. Res. 133, which called for the Federal Reserve to report periodically on its plans for the growth of the monetary aggregates. On November 4, Federal Reserve Chairman Arthur Burns testified for the third time under this new Congressional reporting procedure. (The hearings are held quarterly, alternating between the Senate and House Banking Committees.) He indicated in his testimony that the Federal Open Market Committee (FOMC), the Fed's monetary policy-making body, had voted to target the average rate of growth in M_1 (currency plus demand deposits) at 5 to 7½ percent from the third quarter of 1975 to the third quarter of 1976.

This range of M_1 growth is the same as that which Chairman Burns reported in his two previous trips to Capitol Hill, but it nonetheless represented a slight easing of policy. On this occasion he indicated that while the Fed has kept M_1 growth inside the target range, actual growth over the past six months has been on the high end of the range. If M_1 growth had been at the midpoint of its range during this period, it would have averaged $293.6 billion in the third quarter, rather than the $294.1 billion that actually occurred. Since the FOMC used the actual third-quarter average as the base upon which to target the growth path over the next twelve months, the new 5-to-7½ percent target range actually allows for slightly more money in the economy in the months ahead than the old 5-to-7½ percent range.

Range of criticisms

Although the Fed's control of M_1 is not exact, to date M_1 growth has stayed well within the range reported to Congress. But this achievement has not protected Chairman Burns from criticism in his quarterly visits. In fact, in this brief period the Fed has received considerable criticism from a number of sources for pursuing policies that have been described as being both too tight and too easy.

In May, when testimony first began before the Congressional Banking Committees, many academic economists argued that the Fed deserved a major portion of the blame for the current recession. Some monetarist critics contended that the fires of inflation, fed by the excessive monetary expansion of the early 1970's, had inevitably created the conditions for the recession. Others placed the error in the second half of 1974, when money growth fell to a low 2-percent annual rate despite a sharp fall in interest rates.

There is of course a fundamental distinction between these two supposed mistakes, although the distinction was widely overlooked in the May hearings. Chairman Burns, in his testimony, admitted that 1972 policy in retrospect appears to have been too easy—yet it was a policy favored at the

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time by many leading Congressmen and outside experts. The second half of 1974, on the other hand, appears to have been an especially difficult period for implementing policy in terms of M_1 growth, because the relationship between money growth and interest rates deviated very sharply at that time from its long-term norm.

Money and interest rates

Economists who stress the importance of this relationship believe that the level of short-term interest rates in the second half of 1974 would ordinarily have been consistent with M_1 growth of close to 6 percent, rather than the 2 percent that actually occurred. The FOMC attempts to implement a long-term money-growth policy by setting a short-term goal for the Fed-funds rate, the rate that banks charge each other for short-term loans of reserves. When this money-interest rate relationship deviates significantly from past patterns, the Fed encounters difficulty in controlling money growth under current operating procedures.

Furthermore, at such times, economists have a tendency to split over the question of what the Fed should control, interest rates or money. This issue was raised in the hearings over the Fed's second-quarter money targets. (These hearings were held in July, when the Fed-funds rate was rising above 6 percent.) Economist Arthur Okun of Yale contended that the Fed should *not* try to control the rate of growth in M_1, but rather should maintain the level of the Fed-funds rate at its recessionary low of about 5½ percent—even though (in some analysts' view) such a policy might lead to a 10-to-13 percent M_1 growth over the year, far above the FOMC's 5-to-7½ percent target.

Chairman Reuss of the House Banking Committee seemed to agree with Okun, finding fault with the FOMC decision to permit the Fed-funds rate to rise in June. "It seems to me, with 9 million or more Americans unemployed, with one-third of our factories, plants, and equipment unused because of the recession, that raising interest rates is simply the wrong thing to do. I, therefore, urge you in the Fed to cease and desist from interest-rate raising practices at the present time."

When Chairman Burns gave his most recent testimony in November, the Fed-funds rate was declining and very close to 5½ percent. The thrust of criticism therefore shifted from high interest rates to slow money growth. Two leading economists, Milton Friedman and Paul Samuelson, both argued that the low rate of growth in the aggregates since June could lead to a premature abortion of the recovery. Friedman, it should be noted, was not critical of the FOMC's target rate of money growth. Instead he argued that the Fed should try harder to achieve money targets, ignoring the effects of its actions upon interest rates. He contended that the Fed could and should control money more closely than it has, by sacrificing its concern for the stability of short-term interest rates to a greater concern for stable rates of growth in the monetary aggregates.

Fed forecasts
Congressmen generally have been content to leave the issue of the Fed's operating procedures to the judgment of expert witnesses and to focus their own comments upon the broad economic effects of the Fed's intended monetary policy. But some of them have expressed frustration that Chairman Burns does not provide them with an explicit forecast of these economic effects. He has been accused of reticence to cooperate with Congress on the basis of his refusal to provide such forecasts.

Were this a fair criticism, it would indeed be a serious one, since the Federal Reserve was created by Congress and is ultimately responsible to Congress for its decisions. Still, it is hard to understand how the Chairman can provide Congress with a forecast that does not exist. While the Board of Governors staff produces a forecast that is an integral part of the FOMC decision-making process, each of the 12 members of the FOMC reserves the right to differ with this forecast from time to time. Each policy choice thus may be based on as many different forecasts as there are members of the FOMC.

Should policy be based on a single forecast? One good reason for not doing so is the uncertainty of the effects of any specific FOMC decision. There is room for difference of opinion about the effects upon the economy of a given monetary policy. Responsible monetary policy therefore should be based on a range of possible outcomes rather than a single outcome, so that this uncertainty can be taken into account.

Kurt Dew

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 11/19/75	Change from 11/12/75	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	86,122	– 1,515	+ 2,170	+ 2.58
Loans (gross, adjusted)—total	64,760	– 1,175	– 1,671	– 2.52
Security loans	1,378	– 1,382	+ 31	+ 2.30
Commercial and industrial	23,786	+ 1,019	– 214	– 0.89
Real estate	19,639	+ 10	– 340	– 1.70
Consumer instalment	10,083	+ 13	+ 281	+ 2.87
U.S. Treasury securities	8,612	– 257	+ 3,839	+ 80.43
Other securities	12,750	– 83	+ 2	+ 0.02
Deposits (less cash items)—total*	87,321	– 209	+ 6,777	+ 8.41
Demand deposits (adjusted)	24,399	– 500	+ 1,599	+ 7.01
U.S. Government deposits	470	+ 149	+ 36	+ 8.29
Time deposits—total*	60,717	+ 260	+ 4,998	+ 8.97
States and political subdivisions	5,817	+ 120	+ 134	+ 2.36
Savings deposits	21,603	+ 196	+ 3,537	+ 19.58
Other time deposits‡	29,899	– 41	+ 1,331	+ 4.66
Large negotiable CD's	15,569	– 40	+ 316	+ 2.07

Weekly Averages of Daily Figures	Week ended 11/19/75	Week ended 11/12/75	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	18	57	31
Borrowings	3	1	174
Net free (+) / Net borrowed (–)	+ 15	+ 56	– 143
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+) / Net sales (–)	+ 1,531	+ 2,578	+ 987
Transactions of U.S. security dealers			
Net loans (+) / Net borrowings (–)	+ 544	+ 1,843	+ 462

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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