STATEMENT BY MR. FRANCIS AT ABA MONETARY

CONFERENCE ON JUNE 20, 1969

in

Copenhagen, Denmark

The following is at least close to what I said as a member of the panel on Monetary and Credit Policies in the United States at Session 7 on Friday, June 20, 1969 at the Monetary Conference in Copenhagen. Milton Friedman, Professor of Economics at the University of Chicago, was a lead-off speaker, with Alfred Hayes, President, Federal Reserve Bank of New York; George W. Mitchell, member, Board of Governors of the Federal Reserve System, and myself as panelists. Each panelist was allowed ten minutes. The session was chaired by Edward D. Smith, President, The First National Bank of Atlanta, Georgia.

A friend of mine, upon learning that I would participate in the panel this morning, suggested that to ask me to do a critique of Milt Friedman's presentation was like asking the Pope to criticize the Sermon on the Mount. After listening to Prof. Friedman, I am convinced of my friend's wisdom because I don't find many areas of substantial difference with Prof. Friedman's presentation.

It would be well, I think, to outline in the beginning four things that I believe with reference to the formulation and conduct of monetary policy. This should make it easier to follow the remainder of what I will have to say this morning.

(1) The objectives of our national stabilization policy, as I understand them, is an optimum sustainable rate of growth in total spending, high employment, and stable prices. I see no element of incompatibility in these objectives of stabilization policy and I believe they can be attained.

(2) As a dedicated member of the monetary school, I am convinced of the dominance of monetary influence in stabilization policy. Let me hurriedly add that I believe fiscal policy to be important - not in terms of any direct influence it might have on total spending, but because of the very real influence it has on the formulators of monetary policy.

(3) Money in the restricted sense, or M_1, is the most dependable guide to the influence of monetary policy actions. The broader interpretation of money, or M_2, would be perfectly acceptable except for the influence of Regulation Q. Without Regulation Q influence, there are other monetary aggregates that might be used.

(4) I prefer a discretionary monetary policy formulated and activated by the central bank - always toward the goal of sustainable growth, high employment and a stable currency.

It seems to me that a review of recent monetary policy formulation indicates an interesting absence of discretionary policy except for the periods of the last three quarters of 1966 and since December of 1968. Except for these two periods, I am impressed that monetary policy in the main has been devoted to stabilizing credit markets through interest rate and money market condition targets, and even-keeling the United States treasury. The combination of these actions, it seems to me, means that the monetary policy has been formulated to meet the needs of the treasury - as dictated by the fiscal policies of the United States Congress, and not a policy formulated and activated in the interest of national stabilization objectives. In effect, we have suborninated our interest in the long run stability of the economy to the short-run requirements of the treasury. Stabilization objectives have been left to fiscal policy.

Let's look at several periods within the last five years which seem to me to be excellent case studies and which support my appraisal of recent monetary policy.

1964 was in many ways a most disasterous year of our history. Taxes were reduced, Vietnam was escalated and no effort was made to cut back on non-military expenditures, and the wholesale price level gave a convincing signal of the inflation to come. In the fourth quarter of 1964, total spending began a rapid rise and the general price level began to climb. All this seemed to indicate that the increased rate of expansion in the growth of money to an annual rate of nearly 4% in late 1962 was a little more than could be sustained. However, by mid 1965, rather than a back off in the rate of expansion of money, the annual rate was increased to 6 1/2%.

1965 may be recorded as a year of great clamor for fiscal action. Although some leaders recognized the need for restrained fiscal policy, restraint was not forthcoming. The monetary expansion continued through the first quarter of 1966. By the end of the first quarter of 1966, discretionary monetary policy formulation appeared and stabilization objectives took precedence over money market conditions and even-keeling the treasury. The M_1 growth rate fell to "0" for three quarters. Within two quarters of the onset of monetary restraint, the growth rate of total spending was reduced and the price climb slowed from a 3 1/2% to a 2 1/2% annual rate. Despite the alleged strong expansionary stance of fiscal policy, monetary restraint worked and slowed the economy. Success was short-lived, however, and beginning in January of 1967, the noise of crunch, concern for individual segments of the economy, and perhaps other considerations returned us to a period of stabilizing credit markets and even-keeling the treasury.

M_1 growth abruptly returned to a 7% annual rate which was to endure for a two-year period. Again, within two quarters after the change in the rate of money growth, the growth rate of total spending spiraled and price rises stepped up to a 4% annual rate. With the return to an expansive monetary policy, renewed efforts for fiscal restraint were again wide spread. It finally came in mid 1968 with passage of the surtax and agreement to reduce the rate of growth in federal spending. With the acceptance of fiscal restraint, great concern developed on the part of many about the possibility of overkill and monetary policy was said to have eased shortly thereafter. But, as a monetary analysis would have forecast, overkill did not appear and the economy continued its reckless expansion.

Finally in December of 1968, monetary policy returned to stabilization objectives. Since December of 1968 money has grown to an annual rate of 3% - half that of the previous two years.

While a 3% rate of growth is a higher level than I would have chosen, I still feel that if held to that level, or less, we should see early evidence of slowing in total spending.

While pleased at the monetary restraint that has been accomplished, I feel that Regulation Q has impeded our efforts. There may be some reason for the existence of Regulation Q, but it is my judgment that it is not a reliable instrument of stabilization policy and should not be interpreted as such. Regulation Q needs more study and I expect it will get it. But, I am convinced that Regulation Q does not restrict total credit in the economy, and on the contrary, may well be expansive to a degree. It seems to me that Regulation Q's only accomplishment during the present period of restraint has been undue restraint on banks. I am well aware that monetary policy is effected through the commercial banking system, but I see no reason why banks should not compete freely for funds within an overall restraint on total credit.

Throughout the series of episodes I have recited, one fact stands out - changes in the growth rate of money is followed within a relatively short period by changes in the growth rate of total spending, and in the same direction. This happens irrespective of the alleged direction of influence of fiscal policy.

In addition, studies at our bank and elsewhere provide compelling evidence that the Federal Reserve can exercise a closer control of M_1 (because of Regulation Q) than of other monetary aggregates.

I believe there is growing acceptance of the view that interest rates are not a good indicator of monetary influence.

Furthermore, I am convinced that over the years since World War II, our preoccupation with money market conditions and our commitment to even-keeling the treasury has been more de-stabilizing than stabilizing to our inherently stable economic system.

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