

MONTHLY

Business Review

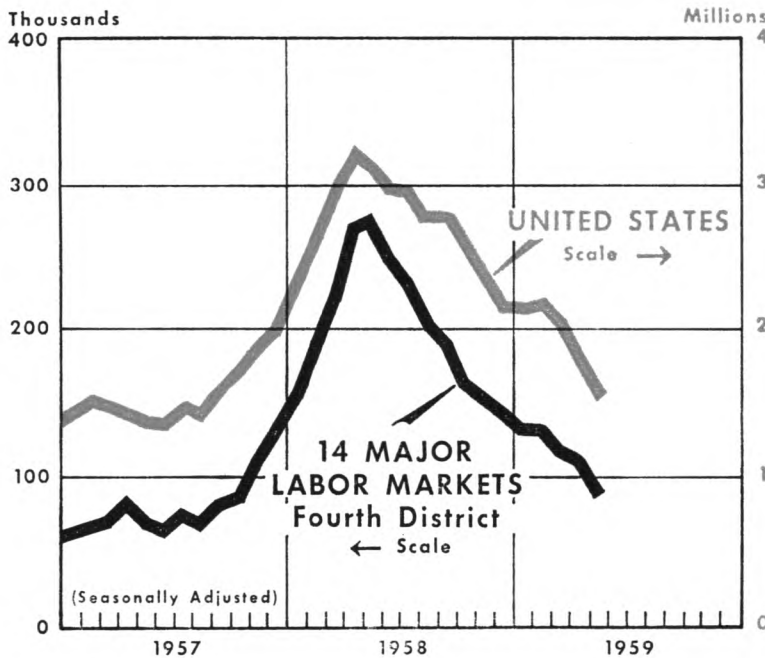
FEDERAL RESERVE BANK of CLEVELAND

July, 1959

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INSURED UNEMPLOYMENT



Insured unemployment in 14 major labor markets in the Fourth District rose more steeply during the recession than did the comparable national total. The rate of fall during the recovery has approximated the rate of drop in insured unemployment nationally.

Continued claims, all programs, at mid-month; last entry, May

The Ebbing Of Unemployment

UNEMPLOYMENT in the nation has dropped sharply since February, after a period of several months when the number of those looking for work showed little change, apart from the usual seasonal fluctuations. The decline in the number of jobseekers has not, however, kept pace with the increase in industrial production and Gross National Product, both of which have surpassed the pre-recession peaks.

The estimated unemployment total of 3,441,000 in May was some 800,000 higher than in March 1957, the prerecession low in unemployment. Unemployment as a proportion of the labor force, i.e., the number of jobholders plus the number of jobseekers, in May was 4.9 percent, compared with 3.9 percent in July 1957. (Data are seasonally adjusted.)

During recovery periods, employment gains typically lag behind increases in output. The current ratio of jobseekers is, however, higher than in the comparable month of the recovery periods of 1949-50 and 1954-55, after adjusting the earlier data for the change in the definition of unemployment which became effective in January 1957. The number of jobless is also larger than in the earlier periods, but comparisons in terms of numbers unemployed include the effects of continuing growth in the labor force; comparisons on the basis of rates are therefore more meaningful for a close appraisal.

Although direct estimates of the labor force and total unemployment are not available for the Fourth Federal Reserve District, some comparisons of unemployment in the District and in the nation are made possible by using the data produced by the operations of the various unemployment insurance programs. These data include the number of persons filing continued claims and the ratio of that

total to the number of persons covered by unemployment insurance in some previous period. This ratio is called the "insured unemployment rate" to distinguish it from the unemployment rate in the Census Bureau data which (as previously cited) expresses the ratio of total unemployment in a particular month to the total number of persons working and looking for work in the same month.⁽¹⁾

Nationally, insured unemployment represents about 60-65 percent of total unemployment, depending on the stage of the business cycle. The data used here exclude persons covered by the various temporary programs put into effect in 1958. The number of insured unemployed, but not the rates, are seasonally adjusted. (The source of all data on insured unemployment used here is the Bureau of Employment Security of the U. S. Department of Labor.)

Unemployment Rise Sharper in District

Insured unemployment in 14 major areas of the District⁽²⁾ for which data are reported monthly increased several fold from June 1957 to the peak month of April 1958, but from then on it dropped very rapidly (see cover chart). By mid-May of this year the number of persons in those areas filing con-

(1) The insured unemployment rate measures only unemployment covered by regular state programs and the program for Federal Government civilian employees. It thus excludes several other special programs, the largest of which are the temporary programs and the program for railroad workers. The rates are not completely comparable between different states because of interstate variations in such characteristics as the size of establishment covered, duration of benefits, and several other legal and administrative factors.

Finally, the unemployment insurance rates are not comparable with the unemployment rate calculated by the Census Bureau, because of the many persons unemployed who are not covered by insurance, who have exhausted their benefit rights, or who do not file claims. The number of exhaustions is likely to be especially large in areas which have experienced substantial unemployment over a long period.

(2) These are the largest metropolitan areas in the District. They contain about nine-tenths of nonfarm wage and salary employment and about four-fifths of all manufacturing employment in the District.

tinued claims for unemployment benefits had receded almost to the October 1957 mark, which was somewhat higher than the pre-recession low.

Nationally, insured unemployment followed the same pattern, but the increase during the downswing in business activity was substantially less than in the District. In mid-May of this year, the national total of insured unemployment had fallen to the September 1957 point; this was closer to the prerecession level than was the District total.

Unemployment in the Fourth District, therefore, was apparently more severe during the recent recession than it was in the nation generally. This was understandable because the principal impact of the recession was felt in the durable-goods manufacturing industries, which are relatively more important employers in the District than they are nationally.

Although the degree of unemployment in the District was greater than in other parts of the nation, the incidence of unemployment varied considerably within the District, as shown by a comparison of the rates of insured unemployment in District states. The rate in Ohio has been consistently below the national average since 1954, except for the first half of 1958, when it was slightly higher. Rates for Pennsylvania, Kentucky and West Virginia (the other three states which are partially included in the Fourth District) have been distinctly higher than the U. S. average during most of the same period, reflecting the large amount of long-term unemployment in those states. The standings of the District states in relation to each other and to the national average are shown in Table 1 for a month prior to the 1957-58 recession, for the month at the bottom of the recession, and for the latest month for which data were available at press time.

Local Areas

Data on trends in employment conditions in local areas of the District, as well as some additional indications of District-wide trends, are provided by the bi-monthly area classifica-

Table 1
RATES OF INSURED UNEMPLOYMENT

| | June 1957 | April 1958 | May 1959 |
|---------------|-----------|------------|----------|
| U. S. | 3% | 8% | 4% |
| Ohio | 2 | 8 | 2 |
| Pennsylvania | 4 | 11 | 6 |
| West Virginia | 3 | 14 | 8 |
| Kentucky | 7 | 14 | 6 |

tions of the U. S. Department of Labor. The District's 14 major labor market areas are classified on the basis of several factors—the proportion of jobseekers in the labor force, the employment outlook in the next two to four months, and the effects of seasonal or temporary factors on the labor supply. Smaller labor market areas are noted only when they are estimated to have unemployment in excess of 6 percent of the labor force, which is defined as a “substantial labor surplus”.

Table 2 shows the standings of the 14 major areas of the District in the latest month prior to the recession, at the bottom of the recession, and in May 1959, the latest month for which classifications are available. The map on page 4 also shows the May standings of the 14 major areas. (The smaller labor market areas are shown only where they were classified as “substantial labor surplus”.) Dayton was the only area which had a slight shortage of labor in May, according to the Labor Department classification, in contrast to the situation in May 1957, when there were 6 such areas.

Most of the areas showed some improvement since May 1958, but unemployment in Erie and Huntington-Ashland in May 1959 exceeded 12 percent of the labor force, while in three other areas it was higher than 6 percent.

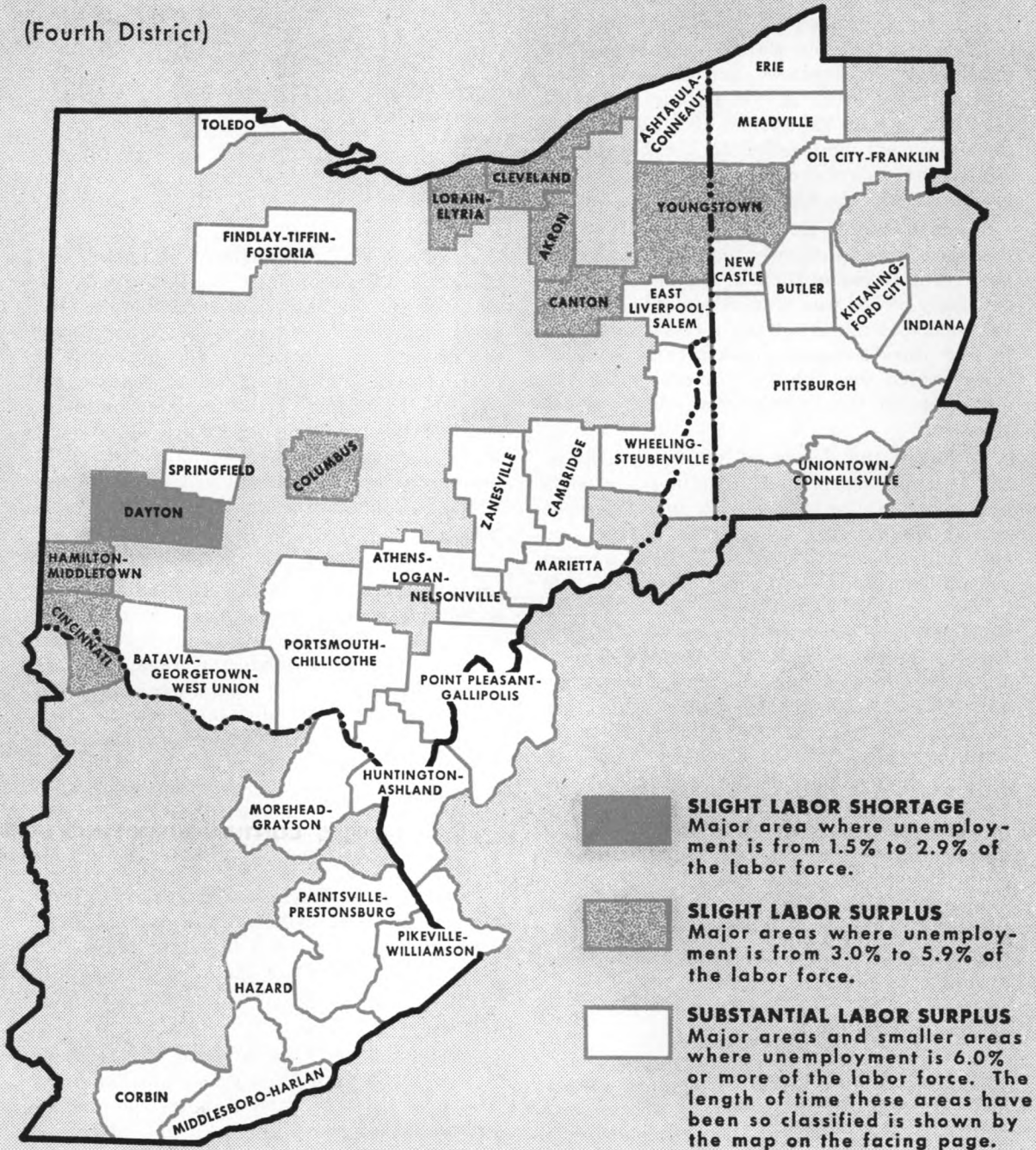
Unemployment also exceeded 6 percent of the labor force in twenty-four smaller areas of the District. As Table 2 shows, the number of smaller areas with substantial labor sur-

(Continued on Page 6)

Classification of Labor Market Areas

as of MAY, 1959

(Fourth District)

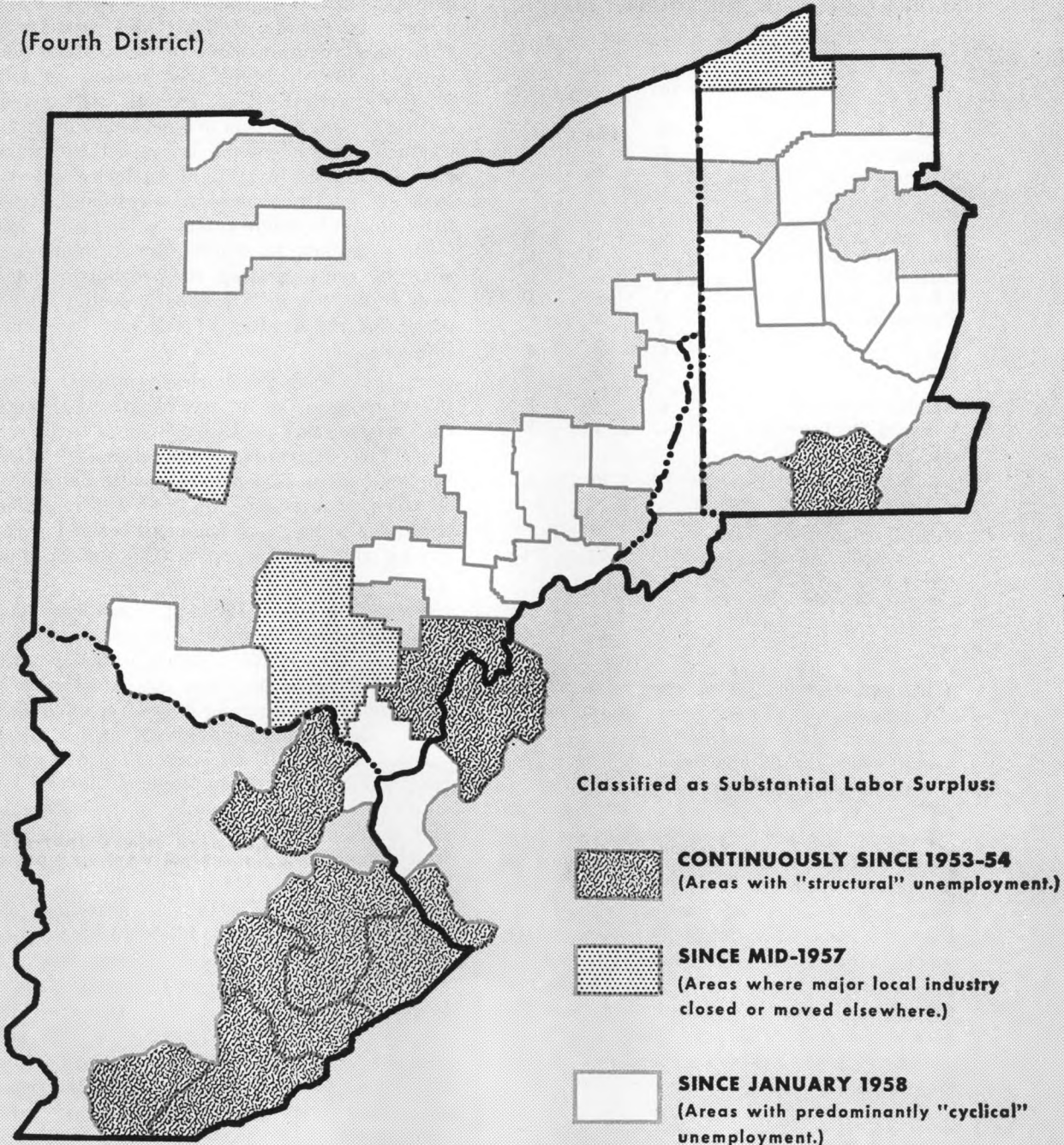


Unshaded areas represent smaller labor market areas where unemployment is less than 6% of the labor force.

Areas of Substantial Labor Surplus

as of MAY, 1959

(Fourth District)



NAMES OF AREAS ARE SHOWN IN THE PRECEDING MAP

Table 2

**CLASSIFICATION OF LABOR
MARKET AREAS IN THE FOURTH DISTRICT**

| | May 1957 | May 1958 | May 1959 |
|--|-------------|-------------|-------------|
| Akron..... | B | D | C |
| Canton..... | B | E | C |
| Cincinnati..... | C | C | C |
| Cleveland..... | B | D | C |
| Columbus..... | B | C | C |
| Dayton..... | C | D | B |
| Hamilton-Middletown..... | C | D | C |
| Lorain-Elyria..... | B | F | C |
| Toledo..... | C | D | D |
| Youngstown..... | B | E | C |
| Erie..... | C | F | F |
| Pittsburgh..... | C | E | D |
| Huntington-Ashland..... | C | F | F |
| Wheeling-Steubenville..... | C | F | E |
| Number of Major Areas with Substantial Labor Surpluses (Classifications D, E, and F) | 0 | 12 | 5 |
| Number of Smaller Areas with Substantial Labor Surpluses (Unemployment in excess of 6 percent of the labor force) | 10 | 23 | 24 |

pluses was larger in May than at the bottom of the recession. The tendency for the number of smaller labor surplus areas to reach its height when the number of such larger areas is already declining was evident in the last recession as in the previous one.⁽³⁾

Because the area classifications are based on estimates of *total* unemployment and employment in relation to the labor force in each area, they are closer in concept to the Census Bureau's national findings than to the insured unemployment data. They cannot be summed up to obtain state and District totals, but they have an offsetting advantage in that they furnish a framework for analyzing unemployment in the District in terms of its principal causes.

(3) That has been the experience in the Fourth District, but it does not necessarily hold for nationwide experience. During the 1957-58 recession, the U. S. figures did not follow this pattern.

Types of Unemployment

One simplified system for classifying unemployment is a division into three categories: frictional, cyclical, and structural. Frictional unemployment refers to those persons who are changing jobs, looking for jobs for the first time, or are without employment during the slack season of a seasonal industry. Cyclical unemployment is caused by short-run downturns in general business activity, such as the three postwar recessions. Structural unemployment refers to long-term joblessness which is caused by technological changes, out-migration of previously dominant industries or firms, or a decline in demand for the product of a locally important industry.

Of these three categories, frictional unemployment tends to be evenly spread through the country, and probably changes little over time. The geographical incidence of cyclical unemployment is more selective, depending on the character and depth of the recession, while the number of persons involved varies during the different stages of the business cycle.

Structural unemployment, considered geographically, is a composite of local problems, involving a relatively small national total. Structural unemployment can also refer to individuals experiencing long-term unemployment. Many such individuals are in labor surplus areas, but some are in areas which have generally high employment levels. Examples are non-white workers, those over 45, and those previously employed in industries which have declined in activity for various reasons.

In terms of the area classifications, frictional unemployment is likely to be the predominant type of unemployment in the "C" classification (unemployment from 3 to 6 percent), while cyclical and structural unemployment are characteristic of the substantial labor surplus status (classifications D, E, and F for major areas), where unemployment is in excess of 6 percent.⁽⁴⁾ Determination of whether an area is experiencing cyclical or structural employment, in

turn, should be made on the basis of the duration of unemployment in that area, the causes of joblessness, and the employment outlook.

"Structural" Unemployment

Of the 29 areas of substantial labor surplus in the District, 8 can be considered as having structural unemployment. They are:

In Kentucky:

- Corbin
- Hazard
- Middlesboro-Harlan
- Morehead-Grayson
- Paintsville-Prestonsburg

In Kentucky and West Virginia:

- Pikeville-Williamson

In West Virginia and Ohio:

- Point Pleasant-Gallipolis

In Pennsylvania:

- Uniontown-Connellsville

(See the map on page 5.) These are the smaller areas that have been continuously classified as substantial labor surplus since 1954.⁽⁵⁾ Six of these areas owe their present plight almost entirely to the decline in employment in the coal mining industry, and in the two other areas, the displacement of coal miners by machinery and the decline in coal production has been an important factor in causing heavy unemployment.

In most of these areas the proportion of persons looking for jobs is considerably higher than 6 percent of the labor force, and many

(4) This should not be taken in any sense to mean that a 6 percent unemployment rate is the optimum level of unemployment, or that a rate as high as 6 percent is properly regarded as "frictional". This figure was chosen because of its use in the area classifications as the boundary line between "moderate" and "substantial" unemployment.

(5) It should be remembered that the smaller areas, although they constitute a large part of the District's geographical area, are much less important in terms of number of people. Nonfarm employment in these 8 "structural surplus" areas amounts to less than 4 percent of nonfarm employment in the District. All 24 smaller areas with substantial labor surpluses represent only about 12 percent of District nonfarm employment.

of them have been unemployed for several years. The classifications for smaller areas do not subdivide the "substantial labor surplus" category, as is done for the major labor market areas, so that no regular estimates are available of how far the unemployment rate is above 6 percent, except for Uniontown-Connellsville, Pennsylvania, where unemployment was estimated at 23% of the labor force in March. Data made available to a Senate Committee in February⁽⁶⁾ showed estimated unemployment rates for other smaller areas in the District. These are summarized in the following table:

Table 3
UNEMPLOYMENT AS A PERCENT OF THE
LABOR FORCE
(estimated)

| State and Area | Rate | Month |
|-------------------------------------|------|-----------|
| Kentucky: | | |
| Corbin | 13% | Sept. '58 |
| Hazard | 18 | " " |
| Middlesboro-Harlan | 16 | " " |
| Morehead-Grayson | 20 | " " |
| Paintsville-Prestonsburg | 15 | " " |
| Kentucky-West Virginia: | | |
| Pikeville-Williamson | 23 | Oct. '58 |
| West Virginia-Ohio: | | |
| Point Pleasant-Gallipolis | 13% | Aug. '58 |

In addition to these 8 areas of long-term unemployment, 3 others in the District have some aspects of structural unemployment. They are: Erie, Pennsylvania, and Springfield and Portsmouth-Chillicothe, in Ohio. In each of them a large plant in the area has closed or, as in the case of Erie, has moved much of its activity elsewhere; in each case large-scale joblessness during the 1957-58 re-

(6) U. S. Congress, Senate, Subcommittee of the Committee on Banking and Currency, *Hearings, Area Redevelopment Act*, 86th Congress, 1st Session, 1959, facing p. 593.

cession appeared several months before it was generally manifested elsewhere—in Springfield in February 1957, and in Erie and Portsmouth-Chillicothe in July 1957. (Erie had previously been moved from the substantial labor surplus category to that of moderate labor surplus—Group C—only in July 1956, almost a year after most other labor surplus areas were reclassified to categories indicating lower levels of unemployment.)

Cyclical Unemployment

The geographic distribution of *recession-caused* unemployment which remained in the District as of May of this year is indicated by the 18 substantial labor surplus areas which acquired that classification beginning in January 1958, as shown by the second of the two maps. At its peak in September 1958, this group had included 30 areas in the District, of which 12 were major labor market areas. Among the 18 areas that were in the group in May were 4 major labor market areas—Pittsburgh, Toledo, Wheeling-Steubenville, and Huntington-Ashland. (In the latter area, the largest part of industry is in the Huntington part of the area, which is outside the Fourth District.)

Heavy unemployment in the four areas just named is related to the lag in hiring by the machinery industries and the stone-clay-glass group of industries. Employment in these industries at last account had not followed the upturn in work forces in the steel and automotive industries, which was the primary factor in the decline in the number of major labor surplus areas.

The causes of joblessness in the smaller areas which were placed in the substantial labor surplus classification after July 1957 are more varied. Several of them were affected by the drop in employment in the machinery and clay products industries. Other industries in which job declines were severe in some smaller areas were iron and steel, railroads, and chemicals. Heavy unemployment in one smaller area resulted from layoffs of residents who had been commuting to jobs in a nearby large industrial center.

The tripartite division of District areas of substantial labor surplus made in this article does not, perhaps, make clear the close relationship between these several types of unemployment, in particular between cyclical and long-term, or structural, unemployment. Areas have been classified here as having structural unemployment if they have been continuously classified as substantial labor surplus areas since 1954. In 1954, at a time of general recession, it was not evident that these areas were going to undergo such a prolonged period of heavy unemployment as they in fact have experienced. By the same token, it is possible that unemployment in some of the surplus labor areas which has been labeled here as recession-caused may turn out to be longer-term in character. If the 1953-54 recession is a guide, the wave of recession-caused unemployment, as it recedes, may leave behind it pools of longer-term joblessness.

Not only are structural and cyclical unemployment difficult to distinguish, except after a time span of several years, but labor market conditions in those areas where joblessness is clearly structural are closely related to conditions in industrialized areas where recession-caused unemployment was heavy. There was considerable evidence during the recession of the return to their home areas of persons who had found jobs in industrialized areas and had subsequently lost them.

Probably more important than reverse migration as an effect of cyclical unemployment is the curtailing of the growth of employment in industrial areas. In periods of high and rising employment, major industrial areas absorb jobseekers from labor surplus areas; recession cuts off that outlet for the depressed areas. Employment gains in the current business recovery, although they may continue to lag behind increases in output for some time, should reopen this outlet for migrants from labor surplus areas. It should be noted, however, that labor market conditions in these areas did not, apparently, improve significantly during the boom years of 1955-1957, when out-migration in search of better jobs was feasible.

A Fourth Surge In Consumer Credit

DURING MAY, time-payment buyers added \$443 million to their outstanding instalment debt. This marked the eighth month in succession in which extensions of consumer instalment credit exceeded repayments. As a result, the level of instalment credit outstanding rose to a new high level of about \$35.0 billion in May. That represented an increase of about \$2.1 billion from the level of instalment credit outstanding a year earlier. Credit extensions in May also set a new high level, increasing \$100 million over the April figure to a record \$4.0 billion.

Various surveys and reports point to a growing number of consumers who are planning to purchase automobiles, refrigerators, appliances, etc., "on the cuff". As a result, the current increase in consumer instalment credit has all the indications of being a fourth surge in the postwar period.

As can be seen from an accompanying chart, instalment credit outstanding has ex-

panded continuously with the exception of three brief periods, from a level of \$2.4 billion in December 1945 to the most recent figure of \$35.0 billion.

Three Slack Periods

In 1951, regulation of the terms of instalment buying, necessitated by the outbreak of the Korean War, forced a slackening in the growth of instalment credit. Again, during the 1953-54 recession, instalment credit stopped rising as monthly repayments ran ahead of new credit extensions in the early months of 1954. More recently, the 1958 recession caused a decline in the year-end total of instalment credit outstanding. As shown by the chart on the next page, this was the only year in the postwar period in which the annual change in instalment credit outstanding was a negative figure.

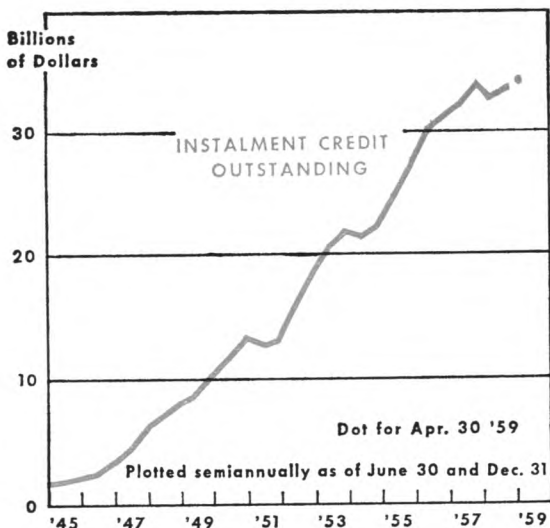
First Expansion, 1945-1950

The first sharp increase in consumer instalment purchases occurred at the end of World War II at a time when consumer debt was abnormally low. Following the war, consumers had large pent-up demands for durable goods coupled with substantial holdings of liquid assets.⁽¹⁾ Personal income was also rising during this period. As a result, the volume of both durable goods purchases and instalment credit rose sharply between the end of World War II and the outbreak of the Korean War in the summer of 1950.

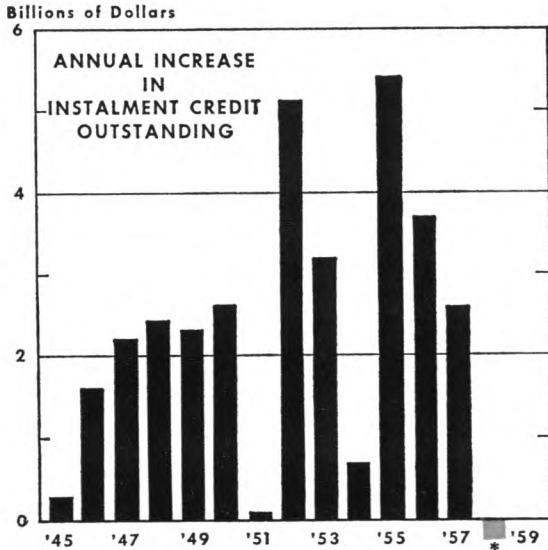
During the early postwar period, consumer instalment credit outstanding increased from a level of about \$2.4 billion in December 1945 to \$13.5 billion at the end of 1950. This represented more than a fivefold increase in the

(1) Many consumers used such assets to make down payments on the purchase of durable goods. This reflected a choice on the part of some consumers to increase their purchases of durable goods and a desire on the part of others to retain a high degree of liquidity.

Consumer instalment credit outstanding has surged upward four times in the postwar period.



Consumers have added to their outstanding instalment debt in every year in the postwar period with the exception of 1958, when instalment credit outstanding fell \$230 million.



* \$0.2 billion decrease in '58

volume of consumer instalment debt outstanding. In the same period, consumer instalment credit rose sharply relative to disposable personal income, i.e., personal income after taxes. In contrast to the rise in consumer debt, disposable personal income increased only 38 percent between 1945 and 1950.

The rise in durable goods expenditures in the five years prior to the Korean War accounted for a substantial portion of the increase in outstanding instalment credit. Expenditures on consumer durable goods increased almost 300 percent in this period, from an annual rate of \$8.1 billion in 1945 to \$30.4 billion in 1950. These movements in instalment credit outstanding, in disposable personal income, and in durable goods expenditures are shown in an accompanying chart.

Second Expansion, 1951-1953

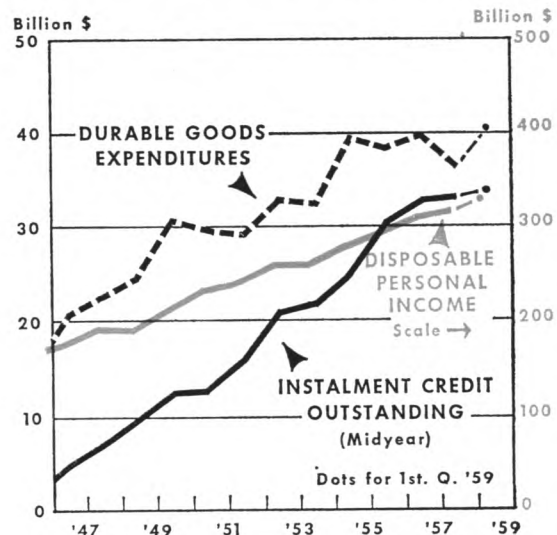
The second period of rapid expansion in instalment credit outstanding began with the suspension of Regulation W at the end of the

Korean War. This time, the rate of growth in consumer instalment debt was less than in the earlier postwar years. Between 1951 and 1953, such consumer debt increased about 60 percent while personal disposable income rose 10 percent. Durable goods expenditures rose almost 12 percent from a level of \$29.5 billion in 1950 to \$32.9 billion in 1953. Thus the rise in durable goods expenditures was of less importance in explaining the rise in instalment credit outstanding in this period. Other factors, such as the acquisition of substantial holdings of liquid assets during the Korean War and the widespread acceptance of instalment buying, help explain the large volume of time purchases which occurred between 1951 and 1953.

Third Expansion, 1954-1957

The third expansion in instalment credit followed the recession of 1953-1954. In many respects, the present recovery from the 1958 recession follows much the same pattern as that set in the 1955 upturn in business activity. Early in 1954, disposable income began

Instalment credit outstanding has increased more rapidly than disposable personal income and durable goods expenditures in the postwar period.



Source of data: Federal Reserve System and U. S. Department of Commerce

rising after having leveled off in the third and fourth quarters of 1953. By the fall of 1954, consumers had started increasing their purchases of automobiles, refrigerators, and appliances. The wide appeal of new car models and intensive competition between car dealers, associated with substantial price discounts, gave a sharp stimulus to the purchase of new cars. These factors are also present in the current recovery in consumer durable goods purchases.

Throughout 1956 and 1957 the liberalization of credit terms played an important part in encouraging a large volume of time purchases. From 1954 to 1957, instalment credit outstanding increased about 52 percent. Personal disposable income rose 19 percent and consumer durable goods expenditures, about 23 percent. In this instance, the easing of credit terms along with the increase in durable goods purchases, was of particular importance in explaining the rise in instalment credit outstanding.

On the other hand, the liberal credit terms in existence since 1958 have left little room for further relaxation at the present time. As a result, the expansive influence of credit liberalization has not been a very important factor in the current increase in the volume of consumer debt outstanding.

Fourth Expansion, 1959-?

A large part of the present upswing in instalment buying, which began in the late summer of 1958 and has continued since then, can be related to the rise in individuals' personal income after taxes. Personal disposable income rose sharply in the third quarter of 1958 and again during the first three months of 1959—reaching a record annual rate of \$321 billion. This rise in disposable income along with a more optimistic view of business activity in 1959 has encouraged a growing number of consumers to make time purchases.

As a result, purchases of consumer durable goods, which are highly sensitive to changes in disposable income, have risen steadily since mid-1958. Durable goods expenditures rose from an annual rate of \$36.8 billion in 1958

to \$40.1 billion in the first quarter of 1959. Previously, in 1958, durable goods expenditures had dropped to a postwar low of 11.8 percent of disposable income. That provided considerable room for recovery to the previous high level of durable goods expenditures sustained in 1955, 1956, and 1957.

Special Factors

In addition to gains in personal income and other general factors in the postwar rise of instalment credit as indicated above, there are several special factors which deserve mention. Some of these have been operative throughout the entire postwar span of years, while others have been especially noteworthy in the most recent rise of instalment credit.

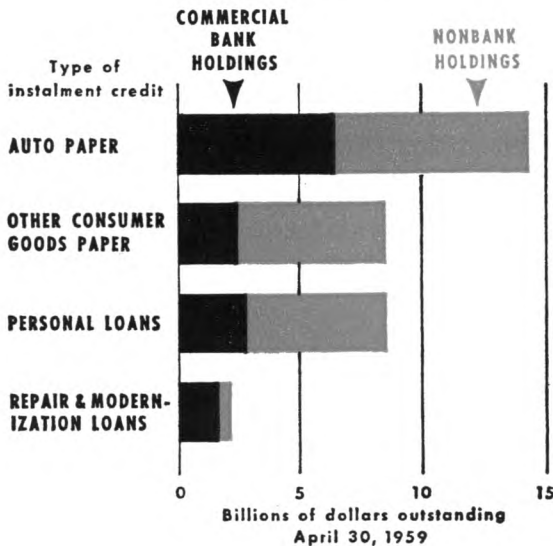
Relative price changes constitute one such factor. The emphasis on the acquisition of durable goods to provide individuals and families with transportation, entertainment, and household services has been encouraged by the steady rise in the prices of services as compared with the prices of consumer durable goods. In many instances, payments for durable goods have in part replaced payments formerly made to the suppliers of services which consumers now perform for themselves.

The growing number and size of family units have also stimulated the growth of instalment credit. Young married couples engaged in setting up a home and raising a family are most in need of durable goods. As a result, they are the group most likely to owe consumer debt.

Liberal terms pertaining to down payments and maturities of consumer instalment loans have encouraged the purchase of durable goods during periods of rising incomes, as already indicated. One reason for the persistence of liberal credit terms since 1957 has been the large number of institutions competing in the instalment credit field. The different types of consumer instalment credit held by banks and nonbank holders can be seen in an accompanying chart.

At the present time, commercial banks are the largest holders of instalment credit. At the end of May 1959, commercial banks held

Commercial banks are the largest holders of instalment credit, accounting for 38 percent of the total \$34.5 billion of instalment debt outstanding.



almost 39 percent of all instalment credit outstanding. Sales finance companies, holding about 26 percent, are next in importance as holders of consumer debt, followed by consumer finance companies and credit unions in that order.

The relatively high rates of return earned on different types of consumer paper make the latter an attractive investment. This is particularly true when one takes into consideration the excellent repayment record of consumers as a whole. As the present recovery continues and consumers increase their time purchases, it is very likely that the demands of consumers for instalment loans will compete even more intensively with other demands for individuals' savings and bank credit. Also, the demand for instalment loans will add to the general pressures for expansion of bank credit; the latter, in turn, will pose problems for the determination of an appropriate monetary policy under the conditions which lie ahead.

NOTE ON FEDERAL RESERVE PUBLICATION

The Board of Governors of the Federal Reserve System has published a 144-page booklet by George Garvy, Adviser, Federal Reserve Bank of New York, entitled:

DEBITS AND CLEARINGS STATISTICS AND THEIR USE

Among the headings are the following: Comparison of Clearings and Debits, Deposit Money Payments and Gross National Product, Seasonal and Cyclical Fluctuations, The Velocity of Deposits, Analysis of Business Fluctuations, Use of Velocity Indexes in Monetary Theory.

Orders for the booklet at \$1.00 per copy (or 85 cents each for 10 or more copies) are taken by the Board of Governors of the Federal Reserve System, Washington 25, D. C. Single copies without charge are available upon request by teachers or libraries.

Public Debt Management⁽¹⁾

by William McChesney Martin Jr.

Chairman, Board of Governors of the Federal Reserve System

AT THE OUTSET, I should like to state that the Board of Governors of the Federal Reserve System agrees that the debt management proposals transmitted to you by the President are necessary and desirable and we urge their favorable consideration.

There are only a few points that I would like to make, but before turning to them, I think it is important that you should understand that I come before you in connection with these proposals not as spokesman for the Administration, but as Chairman of the Board of Governors.

We are living today in a country of unprecedented wealth. It is wealthy, in part, because of abundant natural resources; and, in part, because of the energy and initiative of our people. An even more important distinction between the United States and most other countries is the size and quality of the accumulated stock of capital goods in the hands of producers and consumers. Due to past saving, we enjoy the benefits which flow from a reservoir of housing and durable goods in the hands of consumers, of public facilities, such as highways, school buildings, and waterways, and of industrial plant and equipment. The society in which we live has been popularly characterized as affluent, and despite our proper concern for certain depressed areas—both economic and geographic—I am sure that we can all agree with this characterization.

One consequence of affluence is exposure to instability in the pace of general activity and also in interest rates which rise in periods of boom and decline in periods of recession. In a very primitive economy, where everyone must work as hard as he can to eke out a bare living, additions to stock of capital are largely made by diverting effort directly to production of capital goods. Such borrowing and lending as does take place is effected at interest rates which we would regard as fantastically high. In this type of economy, there is little threat of instability except from natural causes. A drought or an unusually good

season may produce relative poverty or plenty. But the range of economic fluctuation will tend to be fairly small.

The greater the accumulation of wealth the greater are the possibilities for economic fluctuation. These may stem from shifts in the peoples' preferences among the wide range of expenditure opportunities open to them, from changing attitudes toward saving and investment, from over-speculation which undermines the solvency of financial institutions, or, perhaps on some occasions, simply from the arrival at a point where even a high rate of technical innovation fails to induce investment decisions adequate to sustain capital expansion.

It is not surprising that, in a free and wealthy economy, we are unable to counterbalance perfectly, through changes in public policy, the wide shifts that can take place. We always have had, and, I think, always will have, changes in the pace of our economic progress. We can and should work to reduce these fluctuations and strive for the goal of stable growth. At the same time, however, we must recognize that it is highly unlikely that we shall ever achieve perfection.

Fluctuations in our economy express themselves in various ways, and we attempt to gauge them by various statistical measures. If we look at the movements in any of the broad measures of economic activity and compare them with fluctuations in interest rates, the conclusion is inescapable that interest rates tend generally to move upward in periods of prosperity and downward in times of recession or arrested growth. Hence, concerned as we may be about the impact of rising interest rates on the burden of the public debt or on necessitous borrowers, we must recognize that rising interest rates are, in fact, a symptom of broad prosperity and rapid economic growth.

Since the stabilization of monetary systems in key countries after World War II, interest rates have been higher in most other industrial countries than in the United States. This has been a period of great economic growth, very active demands for credit, fur-

(1) Statement before the Ways and Means Committee of the House of Representatives on June 11, 1959.

ther monetary expansion, and continuing, though perhaps abating, inflationary pressures. This past year's rise in interest rate levels here, accompanying economic recovery, has been in contrast to some decline in interest rate levels in Western European countries, where a modest recession came somewhat later than in the United States and Canada.

In the United States, the rise in interest rates has affected all types and maturities of debt instruments. Yields on long-term securities have generally risen by about 2 percentage points since the low point reached shortly after the end of the war. Yields now range from 4 to 4½ per cent on U. S. Government securities of long- and medium-term, over 4½ per cent on many outstanding Aaa corporate bonds, and average over 5 per cent on outstanding Baa corporate bonds. New issues necessarily have to be offered to investors at higher rates.

Despite their recent upward movement, interest rates in the United States are still at levels comparable with those prevailing during much of our history. Long-term rate movements since last summer have been within the range of the period from the early part of this century through 1930. The level is still substantially lower than during most of the nineteenth century. From an historical viewpoint, the present level of rates can hardly be regarded as "out of line" for a period of wide prosperity and growth.

In comparing present rate levels with those of past periods, one of the important things sometimes overlooked is the effect of our necessarily high tax structure on the effective rate of interest. For example, if both the borrower and lender are subject to the 52 per cent tax on corporate profits, the borrowers' net cost and the lenders' net return is a little less than half of the expressed rate. Thus, a market rate of say, 4 per cent, implies for both parties a net rate of a little less than 2 per cent. On its own taxable bonds, the Federal Government, through the income tax, recaptures a substantial share of the interest it pays. When we look at interest rates in long-term perspective, we must bear in mind that net yields after taxes are lower today than a comparison of market rates would suggest, because of the fact that taxes are higher.

Aggressive demands for financing, which, as I have said, are characteristic of prosperous times, represent efforts to attract resources away from current consumption in return for the payment of interest. In a free economy, no matter how affluent, it follows that, when borrowers attempt to attract a larger share of the total product for their purposes, they will have to pay for doing it.

The presence of strong demands on the credit markets from borrowers of all kinds does create a difficult financial problem. Recently credit demands have been pressing on the banking system, and the banks have been accommodating a growing volume of loans.

As borrowers have sought accommodation, banks have raised their prime rate from 4 to 4½ per cent. This is the interest rate that banks charge top-quality customers on short-term loans.

More recently, the discount rate of the Federal Reserve Banks has been raised from 3 to 3½ per cent. The discount rate is the interest rate that is charged by a Federal Reserve Bank when a member bank borrows money from it. This money is often called high-powered money. It is high-powered because it is credited directly to the reserve account of a member bank, and, unless used to finance a payment of currency into public circulation or an outflow of gold or some other development which drains the member bank reserve base, it forms the basis for a multiple expansion of bank credit and money.

For some months, we have been having rapid expansion of bank credit and money, based largely on borrowed reserve funds. The seasonally adjusted money supply—demand deposits at banks plus currency in circulation—has increased by more than \$2 billion in the last four months, an annual rate of growth of about 5 per cent. In the face of developing high-level prosperity and the potential threat of inflationary boom, the Federal Reserve should not be in the position of encouraging an undue expansion of bank credit and money. Hence, the appropriate discount rate under present circumstances is one that does not encourage member bank borrowing and is generally above current rates on short-term market obligations, such as bills.

It is sometimes asserted that the Federal Reserve System should step in and halt the upward trend of interest rates resulting from active demands for loans by supplying sufficient Federal Reserve credit in one form or another to keep interest rates from rising. This cannot be done without promoting inflation—indeed without converting the Federal Reserve System into an engine of inflation.

When such a program was adopted during and following the war, it did succeed for a time in actually pegging interest rates on Government obligations. But, at the same time it promoted and facilitated the dangerous bank credit and monetary expansion that developed under the harness of direct price, wage, and material controls. The suppressed inflation that resulted, we are now well aware, burst forth eventually in a very rapid depreciation of the dollar and even threatened to destroy our free economy.

This experience is very recent and the effects are widely and well remembered. It is now very doubtful whether the Federal Reserve System could, in fact, peg interest rates on Government obligations under today's conditions even if we accepted the inflationary costs, which would be high and would eventually lead to severe collapse. It is certain that the Federal Reserve could not extend interest rate stability to all markets.

The trouble is that the world has learned from wartime inflationary experience. It now knows that inflation follows any effort to keep interest rates low through money creation as the night follows the day. Any attempt on the part of the Federal Reserve to peg rates today would be shortly followed by an acceleration of the outflow of gold in response to demands from abroad, by further diversion of savings from investment in bonds and other fixed interest obligations into stocks and other equities, and by a mounting of demands for borrowed funds in order to speculate in equities and to beat the higher prices and costs anticipated in the future.

Those familiar with the investment markets will confirm to you that such developments would inevitably follow a Federal Reserve attempt to peg interest rates. A simply tremendous volume of bank reserves would have to be thrown into the market through Federal Reserve open market purchases in the attempt to stem the upward pressure on interest rates. As these reserves enhanced inflationary pressures even further, the rush from money and fixed obligations into gold and physical property, as well as the mounting demands for credit to reap speculative profits and to hedge against future inflation, would overwhelm even the most heroic efforts to hold interest rates down. Ultimately, if the gold reserve requirements to which the Federal Reserve is now subject were eliminated, the System might acquire a large proportion of publicly held Government debt of over \$200 billion in this way. True, the interest rate on Government obligations might be said in some distorted sense to have been stabilized by such an operation. Interest rates generally, however, would spiral upward as they always have in every major inflation.

People who save will be unwilling to lend their money at low interest rates even when they expect the depreciation in the value of their dollars to be limited. This is understandable. Take, for example, a corporate financial institution subject to a 52 per cent tax. The after-tax income from a bond yielding $4\frac{1}{4}$ per cent interest would amount to just a little over 2 per cent with the dollar stable in value. If this potential investor had reason to fear that the value of the dollar would depreciate even 1 per cent a year, he would anticipate a very low real return. If the investor had reason to expect a price rise of just over 2 per cent a year, he would foresee a negative real return. Investors are alert today to this way of figuring interest returns.

It might be added that to suggest holding interest rates down by supplying the banking system with reserves through Federal Reserve open market purchases of Government securities, on the one hand, and taking them away with higher reserve requirement increases, on the other, represents a fundamental misunderstanding of how the credit system functions. Obviously, if the net effects on the credit base

are, in fact, offsetting, they make no net addition to the total supply of bank credit, nor do they reduce the demands of borrowers. If they are not fully offsetting, the net result is inflationary. We are all acutely aware of the gigantic size of the publicly held debt that is outstanding and available to provide a basis for such monetary inflation. There is no magic formula by which we can eat our cake and have it too.

If the Federal Government should substitute artificially created money for savings in an effort to prevent interest rates from rising, it would have a reverse effect. It would worsen the very situation that the action was intended to relieve. If you really want to encourage rising interest rates, you have only to follow the prescription of those who argue that interest rates on Government or any other obligations can be pegged by inflating the money supply.

In connection with this discussion, it should be re-emphasized that the Federal Reserve System does not "like" high rates of interest. We are anxious, always, that interest levels be as low as is consistent with sustained high levels of economic activity, with a steady rise in our national well-being, and with reasonable stability for value for the dollar. We cannot, moreover, put interest rates where we would whatever our "likes." Federal Reserve policies can, of course, influence interest rates to some extent through their influence on the rate at which the banking system can add to the credit and money supply. The effectiveness of Federal Reserve policies is always subject to the reaction of borrowers and savers as expressed through the market.

In an economy in which people are alert and sensitive to price changes, the only way to bring about a lower level of interest rates is to increase the flow of real savings or to decrease the amount of borrowing. One important way to do this is to reduce substantially the deficit at which the Government is operating. This will not only relieve immediately some of the demand pressures that are pushing interest rates up in credit markets, it will also reassure savers as to the future value of the money they put in bonds and savings institutions and thus increase the flow of savings into interest bearing obligations.

The proposals before you do not relate to the levels of rates that will prevail in the market, but rather to whether or not the Government will be able to use savings bonds and marketable bonds effectively as parts of its program of debt management. The forthright management of the public debt is an essential part of any program to encourage saving and lower interest rates. We should not force the Treasury to resort to undesirable expedients in order to comply with arbitrary ceilings on either the size of the debt or the rate of interest it pays.

International levels of interest rates among industrial countries are now more closely aligned than in earlier postwar years. This realignment, together

with removal of most restrictions on the movement of capital, reflects progress towards a closer relationship among international money markets, which is the financial counterpart of progress toward sustained growth in output and trade in the free world generally. It also signifies a state of affairs in which capital demands are becoming international in scope and in which they will converge rapidly on the market that is cheapest and most readily prepared to accommodate them. Under these circumstances, interest rates in this country must increasingly reflect world-wide as well as domestic conditions.

We need to remember that today the dollar is the anchor of international financial stability. That anchor must be solid. Realistic financial policies of Government are essential to that end as well as to the end of a wealthy and strong domestic economy. At this juncture of world development, the least evidence of an irresponsible attitude on the part of the United States toward its financial obligations or of its unwillingness to face squarely the issues that confront it in meeting greater demand pressures on resources and prices, would have very serious repercussions throughout the free world.
