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Statement by
Paul A. Volcker, Chairman
Board of Governors of the Federal Reserve System
Washington, D.C.
before the
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives
February 19, 1980

I welcome this opportunity—my first—to appear before this Committee to discuss the Federal Reserve Board's semiannual report on monetary policy. As required by the Full Employment and Balanced Growth Act of 1978, that report presents the objectives for monetary growth adopted by the Federal Open Market Committee for the coming year and relates those objectives to economic trends over the past year and to the outlook for the year ahead.

In presenting the report to the Committee, I would like to make a few more personal remarks about the direction that monetary policy is taking and how those policies fit into a broader framework of action to deal with the evident problems of the economy.

The first point that I would emphasize is that the near-term outlook for real economic activity and employment remains highly uncertain. It never has been easy to forecast the direc-

tion of aggregate activity around cyclical turning points, and as one prediction of imminent recession after another has gone awry, the past year has been a particularly humbling experience for economic forecasters.

Important uncertainties continue to cloud the outlook for 1980. One of the most critical questions is whether consumers, faced with lower real incomes and expecting higher prices, will continue to spend an extraordinarily high proportion of their income despite heavy debt burdens and reduced liquidity. Purchasing power is again being absorbed by sharply higher oil prices, and there is no assurance that that process will quickly come to an end. The President has, of course, submitted his budget for fiscal 1981. But international political developments have raised some new questions about prospects for defense spending in the years ahead, and

there are uncertainties about other elements in the budget as it makes its way through the Congress.

In looking ahead and making judgments about these and other questions, most members of the Federal Reserve Board have shared the views of the Administration and most other economists that an economic downturn will probably develop sometime this year. However, such a result is by no means inevitable, and many forecasters appear currently to be raising their sights.

Unfortunately, the range of uncertainty with respect to inflation is one of how much prices will rise, not whether. Price increases, at least as recorded in the most widely read indexes, could well accelerate in the first quarter, partly because the latest round of oil price increases will be reflected in those numbers. The real question is how much progress can be made in reduc-

Table 1

**GROWTH OF THE NEWLY DEFINED
MONETARY AGGREGATES**

(Percentage change, fourth quarter
to fourth quarter)

	M-1A	M-1B	M-2	M-3
1975	4.7	4.9	12.3	9.4
1976	5.5	6.0	13.7	11.4
1977	7.7	8.1	11.5	12.6
1978	7.4	8.2	8.4	11.3
1979	5.5	8.0	8.8	9.5
	(6.8)*	(7.0)*		
1980 FOMC range ...	3.5-6	4-6.5	6-9	6.5-9.5
[Midpoint]	[4.75]	[5.25]	[7.5]	[8.0]

* Adjusted for effects of introduction in late 1978 of NOW accounts in New York State and automatic transfer accounts nationwide.
SOURCE: Board of Governors, Federal Reserve System.

ing the inflation rate in the latter part of the year.

In the past, at critical junctures for economic stabilization policy, we have usually been more preoccupied with the possibility of near-term weakness in economic activity or other objectives than with the implications of our actions for future inflation. To some degree, that has been true even during the long period of expansion since 1975. As a consequence, fiscal and monetary policies alike too often have been prematurely or excessively stimulative or insufficiently restrictive. The result has been our now-chronic inflationary problem, with a growing conviction on the part of many that this process is likely to continue. Anticipations of higher prices themselves help speed the inflationary process.

Nor can we demonstrate that the result has been beneficial in terms of other objectives. To the contrary, unemployment has been higher in the 1970's than in earlier decades. Productivity growth has declined. Capital spending has not kept up with the needs of a growing labor

force. Financial markets have been disturbed and depressed, and institutions responsible for a substantial share of mortgage financing are coming under strain. The recurrent weakness of the foreign exchange value of the dollar has undercut our economic stability at home and our leadership abroad.

The broad objective of policy must be to break that ominous pattern. That is why dealing with inflation has properly been elevated to a position of high national priority. Success will require that policy be consistently and persistently oriented to that end. Vacillation and procrastination, out of fears of recession or otherwise, would run grave risks. Amid the present uncertainties, stimulative policies could well be misdirected in the short run; more importantly, far from assuring more growth over time, by aggravating the inflationary process and psychology they would threaten more instability and unemployment.

The implications for monetary policy are clear. While there may be legitimate debate about the impacts of monetary policy in

the short run, there is little doubt that inflation cannot persist in the long run unless it is accommodated by excessive expansion of money and credit. Put more affirmatively, restraint on growth in money and credit, maintained over a considerable period of time, must be an essential part of any program to deal with entrenched inflation and inflationary expectations. Accordingly, I see no alternative to a progressive slowing of growth of the monetary aggregates to lay the base for restored stability and growth.

The 1980 growth ranges established by the Federal Open Market Committee for the key monetary aggregates are in line with that basic, continuing objective. In the short run, we believe those targets are fully consistent with an orderly process of economic adjustment and modest growth, provided the inflation rate subsides as the year wears on. We also believe that should inflationary pressures begin to build more strongly in the context of strengthening demand, those same targets would imply strong financial restraint. In fact, the

restraint implied by the new targets would be inconsistent with higher rates of inflation over a significant period of time.

The precise growth ranges are described in the report that has been distributed to you, and can be seen in the perspective of recent years in an attachment to this statement. I should emphasize that all these data are on the basis of revised definitions for the monetary aggregates, described in detail in Appendix A of the report. These definitions incorporate some of the recently developed financial instruments that increasingly have been used in place of more conventional means of payment or claims on well established financial institutions. Because these new forms of "money" or "near money" generally have been expanding rapidly in recent years, the re-defined aggregates tend to have somewhat faster growth rates over the past few years than the comparable aggregates as previously defined. (The aggregates as previously defined are shown in Table 2 attached.) The FOMC's new growth ranges for 1980

should not be directly compared with results based on the former definitions of the aggregates. What is significant is that the ranges for the newly defined aggregates in 1980 are expected to result in further slowing of monetary growth this year, following some deceleration over the course of 1979.

As I implied earlier, the behavior of interest rates and the degree of pressure on financial markets in the year ahead will depend critically on the performance of the economy and the strength of inflationary pressures and expectations. Experience suggests that if real activity in fact weakens, interest rates—particularly for short-term instruments—could tend to decline as demands for money and credit moderate. As inflationary forces tend to recede, the decline could be more pronounced and spread more fully into longer-term markets. *In those circumstances*, such market developments would be constructive, tempering any weakness in real activity and tending to support investment activity and housing. At the same

time, persistent restraint on monetary growth would be consistent with our resolve to resist inflation. The other side of the coin is that continued strong inflationary forces, accompanied by bulging credit demands, would tend to keep financial markets under strong pressure—and that pressure should confine and dissipate those inflationary forces. In either case, movements of short-term market interest rates, such as the Federal funds rate, should not necessarily be taken as harbingers of a fundamental change in the stance of monetary policy; that policy will in any event continue to be directed toward reining in excessive monetary growth.

Let there be no doubt; the Federal Reserve is determined to make every reasonable effort to work toward reducing monetary growth from the levels of recent years, not just in 1980 but in the years ahead.

The policy actions taken on October 6 of last year, which entailed changes in our operating techniques to provide better assurance of containing the growth

Table 2
GROWTH OF THE OLD
MONETARY AGGREGATES

(Percentage change, fourth quarter to fourth quarter)

	M-1	M-2	M-3
1975	4.6	8.4	11.1
1976	5.8	10.9	12.7
1977	7.9	9.8	11.7
1978	7.2	8.7	9.5
1979	5.5	8.3	8.1
	(6.8)*		
1980 FOMC range** ...	3.5-6	5-8	5-8
[Midpoint]	[4.75]	[6.5]	[6.5]

* Adjusted for effects of introduction in late 1978 of NOW accounts in New York State and automatic transfer accounts nationwide.

** Staff estimates of ranges equivalent to those specified by Federal Open Market Committee for the new monetary aggregates.

SOURCE: Board of Governors, Federal Reserve System.

in the money supply, were one demonstration of that commitment. And I can report that developments since that time with respect to monetary and credit growth have been remarkably consistent with our immediate objectives.

We cannot conclude from those results that our procedures ensure that money growth will always remain tightly on a narrow path over short periods of time, or that that is necessarily wholly desirable. From week to week or month to month, the relationship between bank reserves and the money stock is influenced by unpredictable shifts between different types of deposits and among institutions. There are transitory shifts in demands for money, associated for example with tax refunds, strikes, or the weather. Nonetheless, our new procedures should continue to give us better control over the monetary aggregates, and we are studying what, if any, other aspects of our institutional arrangements might be changed to enhance the efficacy of those procedures.

The increase in the discount rate announced on Friday is another reflection of our commitment to keep credit expansion under control. The most recent data for overall economic activity have, as you know, been relatively strong, and the inflation rate is currently responding to the new oil price increases. Stimulated in large part by international developments, indications are that inflationary anticipations have tended to rise once again, and in combination, these developments appear to be generating somewhat greater demands for money and credit. In the judgment of the Board, these develop-

ments underscore the need to take such measures as may be required to maintain firm control over the growth of money and credit.

Sustained monetary restraint is not an easy, automatic, and painless solvent for our economic difficulties; the only claim I will make is that it is essential. It works, in part, by limiting the potential growth in nominal economic activity—that is, growth measured in current, inflated dollars. If other policies are working at cross-purposes, the restraint can be blunt, uneven, and decidedly uncomfortable, with too much of the impact in the short term falling on employment and income rather than on prices.

Our aim must be otherwise. What all of us would like to achieve is as rapid a transition as we can manage to a more stable and productive economy—an economy in which we can have more real growth and less unemployment because inflation is dwindling away, an economy in which real incomes are rising even though nominal wages are rising less rapidly, an economy in which we can compete effectively abroad without a weak dollar.

That transition will be speeded to the extent all of us show, not just in our words but in our deeds, that the fight on inflation is in fact of the highest priority. We cannot expect that workers will long be restrained in their wage demands, or businessmen in their pricing policies, if they feel the consequence of self-restraint will be to fall behind in a race with their peers or their costs. We cannot simply rail at “speculators” in foreign exchange or gold or commodity

markets if our own policies seem to justify their pessimism about the future course of inflation. We cannot reasonably bemoan low savings, historically high interest rates, and congestion in credit markets so long as the return on savings does not reflect the anticipated rate of inflation and the Federal Government itself runs large deficits, adding to borrowing demands.

Rising demands for wages and cost-of-living protection, anticipatory price increases, skyrocketing gold and commodity prices, sharply declining values in the bond markets—all of these are symptomatic of the inflationary process and undermine the economic outlook. But none of them are inevitable, provided we turn around the expectations of inflation.

To achieve that essential objective will require sustained discipline, not just in monetary policy but in other areas of public policy. That discipline will certainly need to be reflected in the budgetary decisions of this Congress.

I fully appreciate the need for structural reform and reduction in taxation. Partly because of inflation, the total tax take, relative to GNP, is reaching a new peacetime high, discouraging investment, adding to costs, and blunting incentives. We need to reverse that process. But the President nonetheless seems to me correct in emphasizing that the time has not yet come for tax reduction. Budgetary balance is neither here nor in prospect. Tax cuts, to put the point simply, need to be earned by spending restraint. That is where the challenge lies.

Beyond the broad decisions about monetary and fiscal policy,

there is much more that can be done here and now to speed up the process of restoring price stability. For instance:

- We can curtail more decisively our dependence on foreign energy, even at the expense of increased costs in the short run, because the alternative is to have still-higher prices imposed on us by foreign suppliers over the indefinite future.

- We can move to eliminate the impediments to competition still imposed in some industries by government regulation.

- We can revise legislation that tends to ratchet up wages at the expense of employment.

- We can review the mass of environmental, safety, and con-

sumer regulations to make sure these worthy objectives are reached without undue impact on costs.

- We can resist pressures to protect industries from foreign competition, particularly those industries with relatively high wage structures and wage settlements which have been sluggish in responding to the changing needs of the American consumer.

The list is neither exhaustive nor new. We have been slow to act because so much of it seems to cut across the grain of political sensitivities and, taken individually, many of the measures will not have a dramatic effect. But taken together, the effect would be large, and none of it is

out of keeping with our basic objectives in economic and social policy.

I sense we are rightly coming to the conclusion that accelerating inflation, declining productivity, and energy dependence are not sustainable options for the United States. In concept, policies to wind down inflation have wide support. What remains is the challenge of converting intellectual consensus into practical action.

The Federal Reserve has a key role to play in that process. We intend to do our part—and to stick with it.

The Texas Labor Market in the Recessions of the 1970's

By James E. Pearce

During the past decade, unemployment was lower in Texas than in the rest of the nation. As Chart 1 shows, however, the difference between the Texas and U.S. unemployment rates widened in the recessions and narrowed during the subsequent recoveries. On an annual average basis, the unemployment rate for the United States was 1 percentage point above the Texas rate in 1971 and 3 percentage points higher in 1975. The narrowing of the difference between the two unemployment rates was slight in the years separating the two recessions, but since the 1975 trough, the differential has declined to about 1.5 percentage points.

The causes underlying the development of this pattern are of considerable local interest. The distinctive behavior of the Texas unemployment rate suggests that the state may be less sensitive than the rest of the nation to the disturbances that cause fluctuations in economic activity. It is also possible, however, that the divergence of the unemployment rates is attributable to a combination of special circumstances that is not likely to be observed again. The events emanating from the formation of the Organization of Petroleum Exporting Countries (OPEC) and the Arab oil embargo provide an obvious example.

This article reviews various shocks to the economy in the 1970's and compares in detail the effects on unemployment in Texas and the rest of the United States. Among the factors receiving attention are differences between the two areas with respect to the distributions of their labor forces across industries and the effect of different rates of population growth. The importance of sets of events that are not likely to occur jointly again is also considered. The article concludes with some tentative forecasts of what to expect in the coming decade.

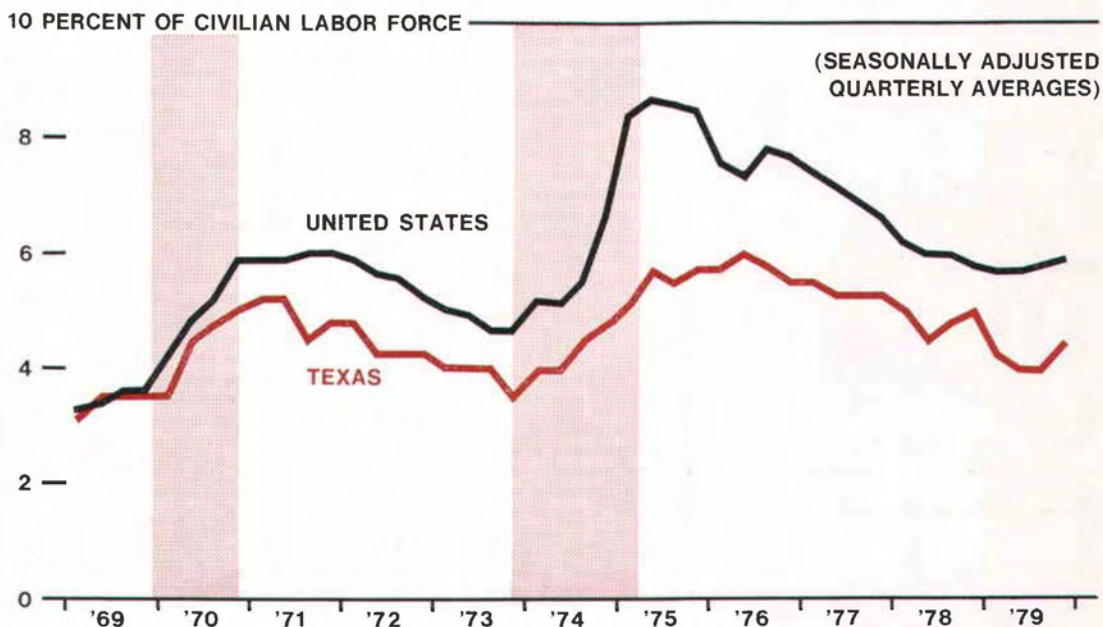
Full-year workers in Texas and the rest of the nation

An analysis of the behavior of labor markets over a period that contains fluctuations in the rate of economic activity can be approached from several perspectives. Candidates for study include wage and salary income, the number of people employed, and unemployment rates. In this article, attention is focused on changes in unemployment among full-year workers.

The decision to confine attention to this group arises from the importance of full-year workers to both the overall economy and individual house-

CHART 1

Texas and U.S. unemployment rates diverged in recent recessions



NOTE: Shaded areas indicate economic recessions as dated by the National Bureau of Economic Research.

SOURCES: U.S. Department of Commerce.
U.S. Department of Labor.
Federal Reserve Bank of Dallas.

holds. A rise in their unemployment is associated with a much larger drop in total economic activity and household disposable income than is a similar increase in unemployment among part-year workers. Although members of this latter group constitute a disproportionately large number of the unemployed, their spells of unemployment are generally shorter than those of full-year workers, for part-year workers have a weaker attachment to the labor force.

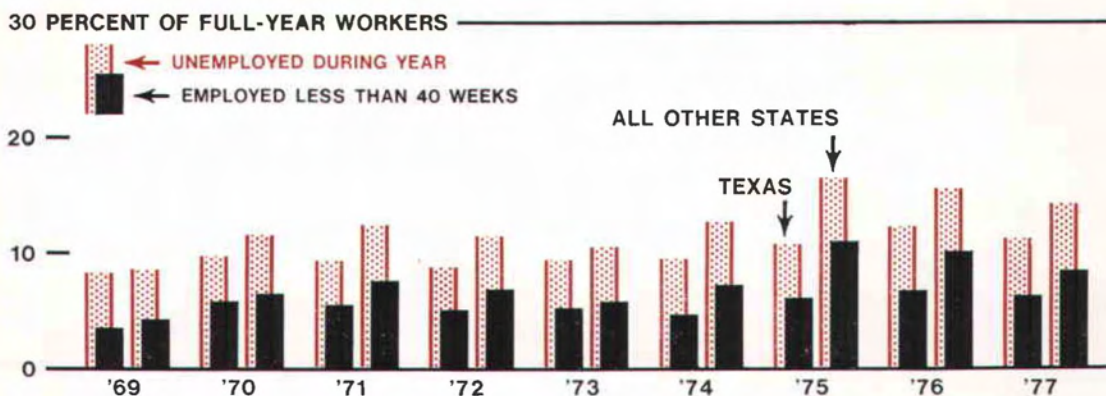
The data used to compare the unemployment of workers in Texas and the rest of the nation were obtained from responses to the March Current Population Surveys for 1969 through 1978. This household survey (conducted monthly by the U.S. Bureau of the Census) is the source of the data used by the Department of Labor in computing official unemployment statistics. For the purposes

of this article, people who were in the labor force at least 40 weeks during the year in question will be considered full-year workers. With this criterion, full-year workers represent about 80 percent of the labor force and about 50 percent of the unemployed.

Differences in unemployment rates may arise from differences in the probability of becoming unemployed and from differences in the average duration of spells of unemployment. Chart 2 contains information on both dimensions for Texas and the rest of the United States. There are two pairs of bars for each year. The left pair shows unemployment for Texas, and the right pair shows unemployment for all other states. The height of each colored bar indicates the percentage of full-year workers who were unemployed at least one week in the indicated year. This provides a basis

CHART 2

Unemployment of Full-Year Workers



SOURCES: U.S. Department of Labor.
Federal Reserve Bank of Dallas.

for comparing the probabilities of becoming unemployed. The height of each black bar indicates the percentage of the full-year labor force that worked less than 40 weeks. This provides a basis for comparing the probabilities of being unemployed for longer periods of time. Changes in the relative heights of the two bars indicate changes in the average duration of a spell of unemployment in the area.

Chart 2 shows the same general pattern found in Chart 1. The second chart reveals a stronger convergence of unemployment in the two areas during the years between the recessions, however, and it illustrates much more dramatically the smaller impact of the 1974-75 slump on unemployment in Texas. In 1975 the percentage of the Texas full-year labor force unemployed at any time was about the same as the percentage of workers in other states that experienced long spells of unemployment, while Texans were roughly half as likely to have worked less than 40 weeks.

Why Texas unemployment was more stable

One of the obvious factors that may explain the difference in the behavior of unemployment in the two areas is the difference in the distributions of the labor forces across industry groups. The sensi-

tivity of employment to fluctuations in economic activity is not the same for all industries, and the Texas labor force has been less heavily concentrated in the relatively unstable manufacturing sector. Table 1 shows that the 1969 and 1973 shares of the Texas full-year labor force in manufacturing were only about two-thirds as large as the corresponding percentages for the other 49 states. Texas

The greater stability exhibited by the Texas labor market arose more from the distribution of workers within manufacturing, particularly in the durables sector, than from the proportion in manufacturing overall.

workers were more heavily concentrated in mining, wholesale and retail trade, and services. Employment in mining and services is fairly stable, while employment fluctuations in trade follow those of other industries in an immediate area. When demand for the output of other employers in a region becomes weak, household income and

Table 1

**DISTRIBUTION OF FULL-YEAR WORKERS,
BY INDUSTRY GROUP**

Industry group	Percent in industry group					
	1969		1973		1978	
	Texas	All other states	Texas	All other states	Texas	All other states
Agriculture	5.0	4.9	5.8	3.9	4.4	3.8
Mining	1.8	.7	2.1	.8	2.9	1.0
Construction	8.2	6.3	7.0	6.7	9.8	6.6
Manufacturing						
Durable	11.4	17.8	9.1	15.9	9.5	13.9
Nondurable	9.4	11.8	8.7	10.7	8.1	9.4
Transportation, communications, utilities	7.8	7.0	7.3	6.9	6.6	7.0
Trade	20.0	17.5	21.3	19.0	22.1	19.2
Services	30.5	27.9	32.1	30.4	31.4	32.8
Government	5.9	6.1	6.6	5.7	5.2	6.3

SOURCES: U.S. Department of Labor,
Federal Reserve Bank of Dallas.

spending do not remain high enough to sustain the region's retail sales volume.

Although the difference in the distributions of workers across these industry groups is substantial, it actually accounts for a negligible amount of the difference in the behavior of unemployment during the 1970's. If the distribution of full-year workers in Texas had been identical to the distribution of workers in the rest of the nation, the proportion of Texas workers ever unemployed during 1975 would have been only 1 percentage point higher than the level indicated in the chart. The greater stability exhibited by the Texas labor market arose more from the distribution of workers within manufacturing, particularly in the durables sector, than from the proportion in manufacturing overall. The behavior of the markets for residential construction in the two areas over this period was also important.

Table 2 and Chart 3 are helpful in making more detailed comparisons. Table 2, which shows the composition of the durable and nondurable manufacturing labor forces in the two areas, reveals a heavy concentration of Texas workers in aircraft production—the primary Texas industry in the "other" transportation equipment category—and in the chemical and oil refining industries. On the other hand, Texas has relatively few auto workers.

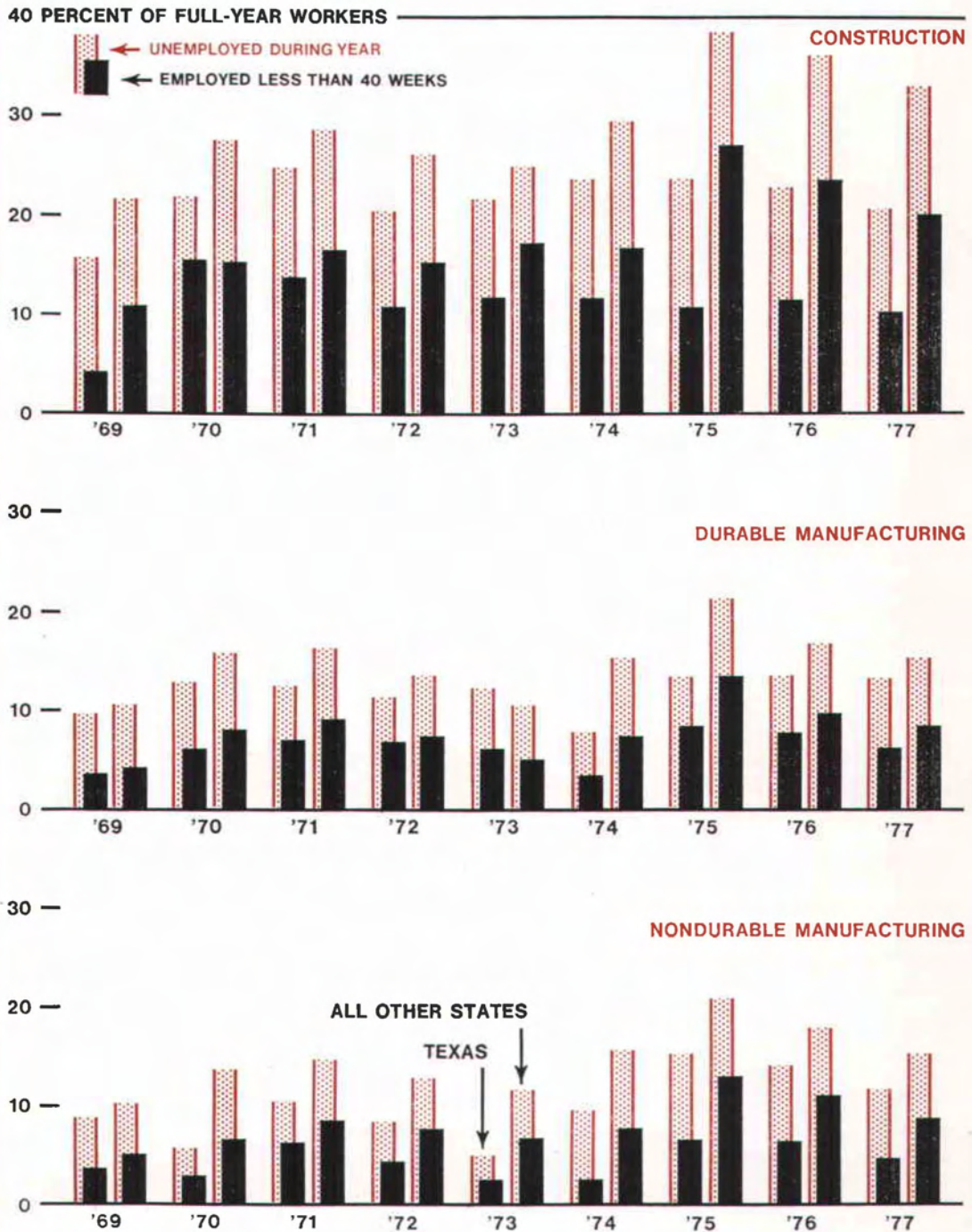
Chart 3 shows unemployment in the two areas for the three industry groups that had the highest and most variable unemployment rates and, therefore, are most important in accounting for the differentials in unemployment noted earlier. Each panel illustrates the same aspects of unemployment for one industry group that were shown in Chart 2 for the entire labor forces of the two areas. Chart 4 plots indexes of residential construction activity in Texas and the nation as a whole.

Reductions in the demand for housing structures and in the Federal Government's purchases of war materials were dominant factors in the recession that opened the decade. A two-month strike against General Motors late in 1970 by the United Automobile Workers also contributed to the slump. Employment in manufacturing, which had been growing at an annual rate of 2.5 to 3.0 percent since 1965, fell 9 percent in the two-year period beginning in August 1969. Cuts in defense production accounted for about a third of this drop.

In Texas the construction and aircraft industries were affected most. The recession hit the construction industry harder in Texas than in the other states, and the state's construction workers experienced a large rise in long-duration unemployment. Employment in aircraft production in Texas fell from 78,000 in 1969 to 39,300 in 1972. Unem-

CHART 3

Unemployment of Full-Year Workers in Selected Industry Groups



SOURCES: U.S. Department of Labor.
Federal Reserve Bank of Dallas.

Table 2

**DISTRIBUTION OF FULL-YEAR WORKERS
IN MANUFACTURING, BY INDUSTRY**

Industry	1969		1973		1978	
	Texas	All other states	Texas	All other states	Texas	All other states
Percent of durable manufacturing labor force						
Lumber; furniture; stone, clay, glass	14	14	14	15	19	16
Metals	18	24	23	23	22	21
Machinery	35	34	37	35	39	36
Transportation equipment						
Motor vehicles	2	10	4	9	2	9
Other	26	11	15	8	12	8
Other durables	5	7	7	10	6	10
Percent of nondurable manufacturing labor force						
Food, tobacco	26	22	25	22	23	23
Textiles, apparel	20	29	20	27	24	25
Paper, printing	19	23	18	24	16	25
Chemicals, petroleum	30	16	34	16	28	16
Rubber, leather	5	10	3	11	9	11

SOURCES: U.S. Department of Labor,
Federal Reserve Bank of Dallas.

ployment for all durable goods industries combined rose less in Texas than in the rest of the nation, however. The causes for this probably lie in the small automobile sector and in the small share of Texas employment in defense-oriented industries other than aircraft. Other regions had larger concentrations of workers in aerospace, electronics, ordnance, and shipbuilding and, thus, suffered larger increases in manufacturing unemployment.

The 1974-75 recession was dominated by large declines in the production of automobiles and residential structures. Employment in the auto industry fell 19 percent from 1973 to 1975. The construction industry boomed from 1970 to 1972, when the index of residential construction in the United States rose more than 60 percent. The subsequent decline was steep, however, and in the first quarter of 1975 this index was less than half its peak nine quarters earlier.

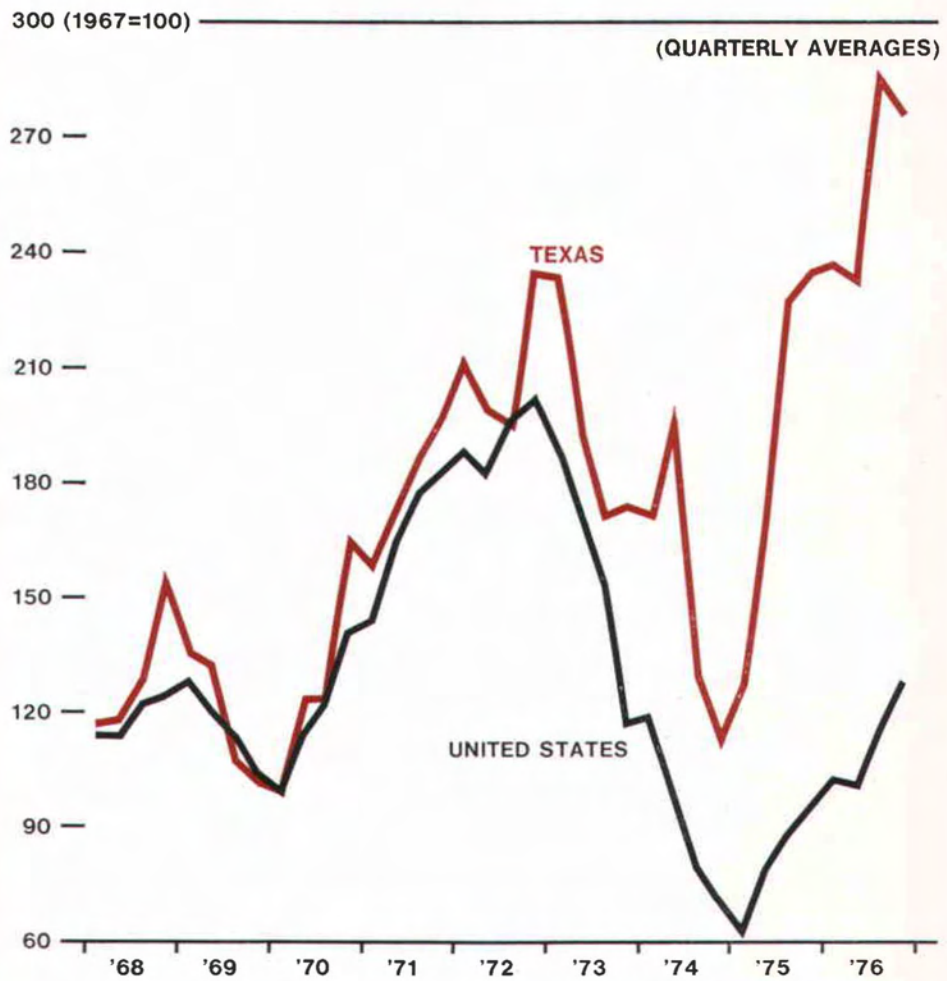
In this second recession, Texas construction workers fared much better than their counterparts in the other states. Housing starts in Texas rebounded much more strongly from their trough, as net migration into the state reached a 10-year high in 1975. The development of an interesting contrast in the growth of the labor forces in the two areas also contributed to the lower unemploy-

ment among Texas workers. From 1968 to 1972, the proportion of the nation's construction workers living in Texas declined slightly, even though the state experienced a larger increase in housing starts than the United States over this period. Thus, the Texas market for these workers had become relatively tight by the time housing starts peaked, so there would have been a smaller rise in their unemployment even if the decline in demand had been equal in both areas.

In the durable manufacturing sector, Texas workers also experienced less unemployment than workers in the rest of the country. One factor that at least partially accounts for their more favorable experience is the stronger performance of the Texas construction industry, on which lumber and furniture producers are heavily dependent. In addition, the decline in auto sales again had little impact in Texas. Perhaps the most important single factor, however, was the sharp rise in the price of crude oil. Stimulated by this development, employment in the oil field machinery industry in Texas rose 15 percent from 1973 to 1974. This industry is heavily concentrated in the state; in 1974, Texas producers employed 70 percent of the nation's oil field machinery workers. Thus, following the formation of the OPEC cartel, unemployment in

CHART 4

Texas housing starts fell with U.S. starts in 1969 but recovered faster in 1975



SOURCES: Bureau of Business Research, University of Texas at Austin.
U.S. Department of Commerce.

total manufacturing initially declined in Texas but rose elsewhere as the demand for large automobiles fell.

Prospects in future recessions

This review of events of the middle 1970's suggests that some special circumstances combined to produce much of the large 1975 disparity between unemployment in Texas and unemployment in the rest of the nation. A difference of this magnitude should not be anticipated in future recessions. Although the demand for oil field equipment will probably remain high, an increase such as the 1974 jump is not likely to occur simultaneously with declines in other industries again. The rest of the nation shows no sign of beginning another episode of speculative construction activity, and the 1975 increase in the level of net migration into Texas, which was at least partly attributable to superior job opportunities, may not recur.

Some special circumstances combined to produce much of the large 1975 disparity between unemployment in Texas and unemployment in the rest of the nation. A difference of this magnitude should not be anticipated in future recessions.

The 1970-71 experience also suggests the Texas unemployment rate may follow the national rate more closely in the 1980's. This recession demonstrated that the Texas construction industry is not invulnerable. Moreover, the distribution of

the effect of the 1970 defense cutbacks suggests that the increase in military expenditures anticipated for the near future will probably stimulate economic activity more in other regions than in Texas and will provide the state with less cushion against any decline in private sector spending than other areas will receive.

In addition, since 1973 there have been some developments that will probably cause Texas unemployment to be more responsive to changes in aggregate economic activity. One such development is that the Texas economy has become more sensitive to changes in the level of construction activity. The recent high rate of population growth has caused the percentage of the Texas labor force engaged in construction to rise, and this has been accompanied by an increase in the proportion of Texas durable goods workers producing lumber and wood products. The stability of Texas unemployment in nondurable goods has also fallen. In the past, it has been high because of the concentration of refineries and chemical plants in the state. The percentage of the Texas labor force in these industries has declined, however, since employment in apparel production, a relatively volatile industry, has increased more rapidly.

Despite these considerations, the Texas economy should be somewhat more robust than the national economy in the next recession. Population growth remains high, and the demand for military aircraft is expected to continue strong. Employment in automobile production, which continues to be highly unstable nationwide, is still a small part of the Texas economy. In the near future, therefore, although the unemployment rate in recessions can be expected to rise less in Texas than in most other regions, the divergence is not likely to be as great as it was in 1975.

“Fed Quotes”

Brief Excerpts from Recent Federal Reserve Speeches, Statements, Publications, Etc.

“Monetary policy has a central role to play in combatting inflation. But our recent experience underscores the complexity of the inflationary process—prices respond to a host of factors, including credit growth, demand management policies, external price shocks, productivity trends, expectations, and many others. In view of this, I believe that we must develop a coordinated set of policies designed to attack inflation from a number of directions rather than placing the entire burden on monetary policy. In theory, monetary policy could do the job alone; in practice, complementary policies are needed to smooth the path and build the base for sustained growth. Moreover, if we are to return to a noninflationary environment it must be recognized that persistent application of anti-inflation policies over an extended period is essential.”

Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System (Before the Joint Economic Committee of the U.S. Congress, February 1, 1980)

“This brings me logically to the question of whether reserve requirements need to be applied to money market funds in order to enhance monetary control. The Board’s answer at this point is that it does not appear to be a critical problem. There are, after all, a wide variety of financial instruments, having varying degrees of liquidity, that may act as substitutes for deposits. But if money market fund shares over time begin to exhibit more clearly the characteristics of transactions accounts, we may have to reconsider our position. So long as balances may be accessed by check writing or other immediate transferability features, the possibility remains that they may develop into a substitute payments system. If so, and in the context of our pressing need for a system of universal reserves on transactions balances as a means to insure effective monetary control, extension of the concept to money market mutual fund shares would then come to be in the public interest.”

J. Charles Partee, Member, Board of Governors of the Federal Reserve System (Before the Subcommittee on Financial Institutions, U.S. Senate, January 24, 1980)

"For the longer run one must ask whether the world's banking system can meet increasing demands by the LDCs [less developed countries] even if these demands reflect genuine investment financing rather than the financing of consumption-oriented oil imports. The banks have, in a sense, pioneered LDC lending. Their lending practices have many desirable attributes that would make a continued strong role of the banks in LDC financing constructive.

"There is no shortage of funds in world financial markets, thanks not only to OPEC surpluses, but to the demonstrated ability of the Euromarkets to draw funds from all over the world by offering attractive interest rates. Nor is there a shortage of high quality assets in which OPEC and other surplus countries, if there are any, could invest these surpluses. The difficulty resides in recycling these funds toward the deficit countries, where they would be at some risk. It seems incumbent on OPEC to assume some of the risks inherent in the process.

"New forms of bank pioneering may be needed. For instance, banks might take on the role of arrangers or brokers of loans. The risk of such loans would fall on the ultimate lender, instead of a bank substituting its own credit for that of the borrower. Such activities would not strain the banks' capital ratios."

Henry C. Wallich, Member, Board of Governors of the Federal Reserve System (At the Conference on New Approaches and Techniques for Managing Country Risk, New York, New York, January 24, 1980)

"Our policy, taken in a longer perspective, rests on a simple premise—one documented by centuries of experience—that the inflationary process is ultimately related to excessive growth in money and credit. I do not mean to suggest that the relationship is so close, or that economic reality is so simple, that we can simply set a monetary dial and relax. Changes in spending and saving habits, the shifting characteristics of different financial instruments having some of the characteristics of money, and the inflationary process itself, all affect the observed relationship between money and economic activity. The increased openness of our economy in general, and the growth of international financial markets in particular, has long since ended illusions of autonomy in policy. Spending and tax policy, a whole range of government regulatory policies, and the behavioral patterns of business and labor all affect the performance of the economy, and the relationship between money, inflation and economic activity. But, with all the complications, I do believe that moderate, non-inflationary growth in money and credit, sustained over a period of time, is an absolute prerequisite for dealing with the inflation that has ravaged the dollar, undermined our economic performance and prospects, and disturbed our society itself."

Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System (Before the National Press Club, Washington, D.C., January 2, 1980)

Volatile World Events Affect Eleventh District Rice Producers

By Don A. Riffe

Early in the 1979-80 rice marketing year, which began last August, there were ominous clouds on the horizon for rice producers. First, a record harvest, combined with large carryover stocks, gave the United States its largest supply of rice in history. Second, there appeared to be little immediate prospect of regaining significant sales to two of the country's largest commercial export markets, Iran and Nigeria. But only a few months later the horizon has cleared noticeably. Export sales have picked up more than had seemed probable, owing to some favorable developments in the volatile arena of international trade.

Nonetheless, rice prices in the Eleventh Federal Reserve District were adversely affected for a time, and District producers face considerable uncertainty in planning the 1980 crop. Much of this uncertainty relates to political and economic conditions in other parts of the world.

Industry heavily dependent on exports

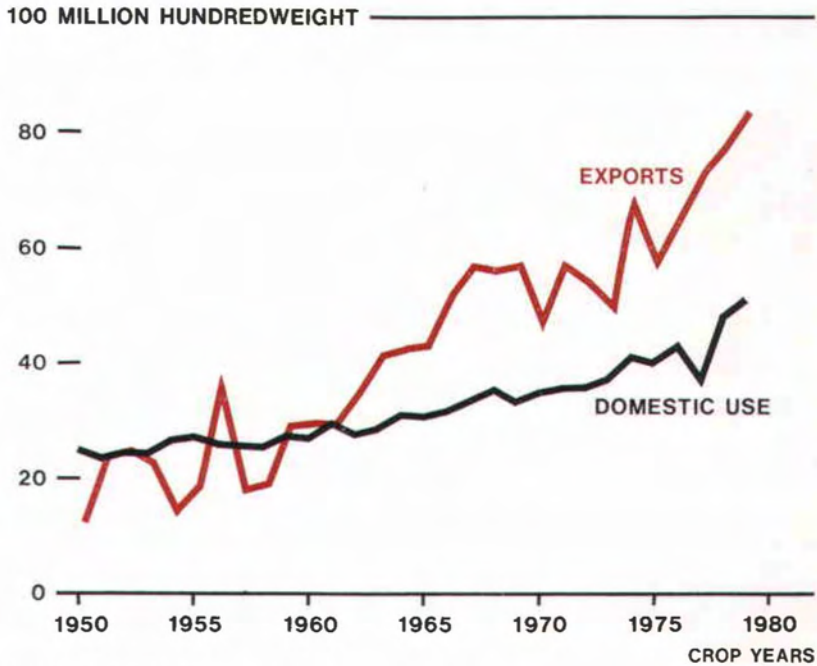
For most of the world's population, rice is a principal part of the diet. Americans, however, annually consume only about 6 pounds per person in direct food use. About 4 more pounds per person are used in processed foods and brewing. With that relatively low level of per capita con-

sumption, exports have played an important role in the growth of the rice industry.¹ In recent years, exports have accounted for up to two-thirds of annual usage, or "disappearance," of U.S. rice supplies. And while the United States annually produces less than 2 percent of the world's rice, this country has been the world's largest exporter in three of the past five years.

Exports of rice fall into one of two categories: commercial sales or shipments under Government programs. Most shipments under Government programs are simply sales for which the U.S. Government has made long-term loans to purchasing countries. A relatively small amount of rice is actually purchased by the Government for export, primarily for donations to aid people in need. In the 1970's, exports of milled rice under Government programs ranged from 70 percent of total exports in 1972 to 24 percent in 1978. While the trend has been toward fewer Government ship-

1. For a thorough discussion of the rice industry and the various rice-producing areas, see U.S. Department of Agriculture, Economics, Statistics, and Cooperatives Service, *U.S. Rice Industry*, by Shelby H. Holder, Jr., and Warren R. Grant, Agricultural Economic Report No. 433 (Washington, D.C.: Government Printing Office, 1979).

Exports have played an important role in the expansion of U.S. rice production



Forecasts for 1979.

SOURCE: U.S. Department of Agriculture.

ments, such shipments will probably continue to be significant, as many less developed nations are expected to have food grain deficits and most have limited ability to pay for imports.

Domestic rice prices have been very sensitive to world demand since 1972. Prior to that year, domestic rice prices were influenced heavily by Government price supports. To help move U.S. rice in world markets, a payment representing the difference between the U.S. support price and the lower world price level was made to exporters. These export subsidies were stopped in 1972, when world prices rose above the U.S. support price, and have not been made since that time. Like wheat and feed grain producers, eligible rice producers have target price and loan rate protection from seriously depressed prices. However, rice prices have generally remained above support levels since 1972.

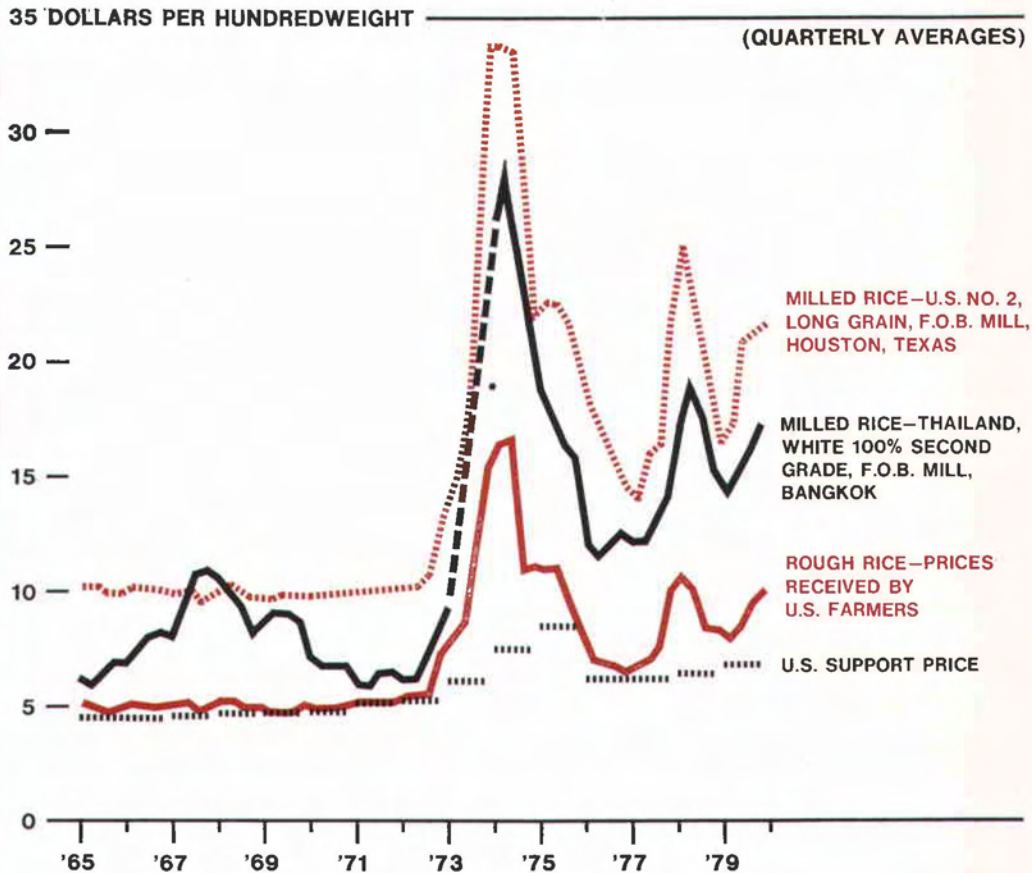
Production concentrated, highly mechanized

Rice is considered a major crop in only six states. The U.S. Department of Agriculture (USDA) estimates that those six states accounted for about 99 percent of total production in 1977. Production is concentrated in the coastal regions of Texas and Louisiana, the states bordering the lower Mississippi River, and Central California. Two Eleventh District states, Texas and Louisiana, produced about a third of the 1979 crop.²

Rice farming operations are highly mechanized and capital-intensive. Typically, rice farms are larger than other farms in the same area. According to USDA estimates, only 9,612 farms—or less than 1 percent of all farms—grew rice in 1974. Of those, 1,574 were in Texas and 3,035 were in

2. Louisiana has two principal rice-producing areas, but only one is in the Eleventh Federal Reserve District.

Domestic prices became more sensitive to world events after 1972



*Not available.

SOURCE: U.S. Department of Agriculture.

Louisiana. Average rice acreage per farm was 358 acres in Texas and 222 acres in Louisiana. As is often the case in agriculture, many of the technological developments introduced over the years have encouraged increased rice farm size to help reduce unit costs. Expansion appears to occur primarily through renting of additional land.

Rough rice is marketed either by private sales or through some type of producer cooperative arrangement. In Texas and Louisiana, private sales predominate, although cooperatives do handle about a third of the crop. Most rough rice is purchased by mills, where cleaning, hull removal,

bran removal, and sizing are performed. The milled rice can then be distributed to domestic and export markets for direct food use or processed further into a number of different products.

Rice types differ in characteristics

Classified by length of grain, there are three types of rice: long grain, medium grain, and short grain. These "types" differ not only in size and shape but also in cooking and chemical characteristics. Consumers in various parts of the world have definite preferences for particular types of rice and for specific varieties within types.

The differences in rice types and in the demand for various types have important implications for District rice producers. About 97 percent of the rice planted in Texas in 1979 was long grain, while Louisiana acreage was almost equally divided between long-grain and medium-grain rice. Countries in Africa and the Middle East tend to purchase more long-grain rice, while countries in Asia and Oceania tend to purchase more short- and medium-grain rice. At the end of 1979, long-grain prices were declining, largely because of the Iranian situation, while prices for short- and medium-grain rice remained strong. Thus, the loss of any specific market may have a much greater impact on rice farmers in some areas than in others.

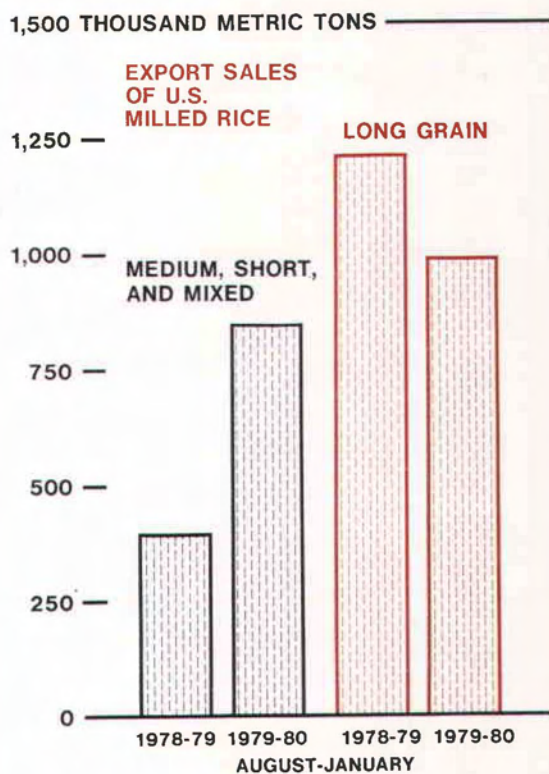
Outlook encouraging, but uncertainty remains

World rice production in the 1979-80 crop year is projected to be down about 3½ percent from a year earlier, with India accounting for most of the decline. The largest major exporters in calendar year 1980 are expected to be Thailand, the United States, the People's Republic of China, Pakistan, Burma, and Japan. Japan's presence as a major exporter is noteworthy, since that country has not often exported large quantities of rice. United States exporters may face increasing competition from Japan in years to come, since its population is changing consumption patterns as incomes rise and substituting other foods for rice.

The near-term outlook for U.S. rice, especially high-quality long-grain rice, hinges on events in Africa and the Middle East. For a time in 1979, the Nigerian government banned all rice imports in an effort to improve its balance-of-payments situation. Meanwhile, the much-publicized turmoil in Iran halted sales of U.S. rice to that country. Iran and Nigeria ranked second and third largest, respectively, among importers of U.S. rice in 1978. Of particular importance to District producers, purchases of U.S. long-grain rice by these two countries in calendar year 1978 amounted to about 23 percent of domestic long-grain production.

Fortunately, several factors have brightened the outlook since the beginning of 1980. Nigeria has come back into the market for U.S. rice and is expected to purchase more than half its year-earlier volume by the end of the 1979-80 crop year. Some U.S. rice appears to have been reaching Iran through third-party countries, and there are signs

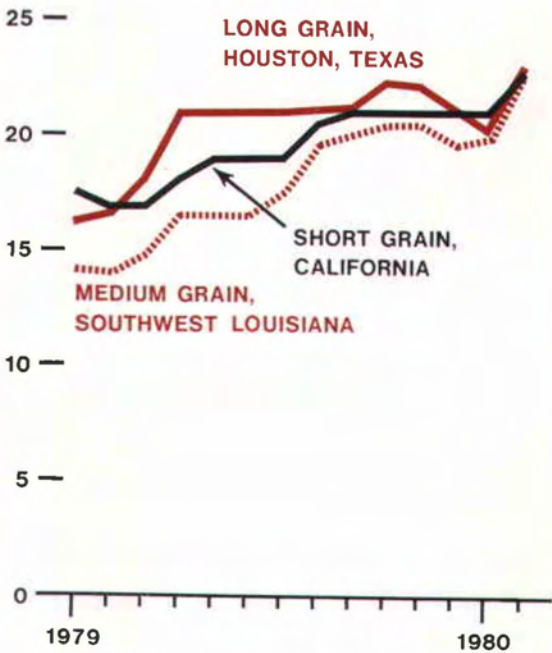
Long-grain exports have fallen behind last year's amount



SOURCE: Rice Millers' Association.

Changing market conditions have recently altered price relationships among rice types

30 DOLLARS PER HUNDREDWEIGHT, BAGGED —



SOURCE: U.S. Department of Agriculture and California Department of Food and Agriculture.

of improvement in U.S.-Iranian trade relations. Also, sales of medium-grain rice to the Republic of Korea have been much larger than earlier anticipated.

On the supply side, the USDA revised its estimate of 1979 rice production downward by 3 million hundredweight to a total of about 137 million hundredweight—still a record but by a substantially smaller margin. It is now estimated that rice exports will reach 83 million hundredweight in the current crop year, up from an earlier expectation of 79 million hundredweight, leaving carryover stocks only slightly larger than at the end of the previous year. Given the current brisk demand for medium-grain rice and the relatively small supply of the short-grain type, an unusually high proportion of carryover stocks will be long-grain rice.

For producers of short- and medium-grain rice, the outlook is very favorable. For long-grain rice producers, it is clouded somewhat by the specter of large carryover stocks and the uncertainty of markets in Africa and the Middle East. In the USDA's January 1 prospective plantings survey, producers indicated that they would plant about 8 percent fewer acres to long-grain rice and about 22 percent more acres to medium-grain rice than in 1979. Such a change in the acreage mix would seem consistent with the changing relationship between medium- and long-grain prices apparent at the beginning of the year. However, long-grain prices increased significantly in February as export sales picked up. Long-grain prices and acreage could receive a considerable boost from any moves toward normalization of trade with Iran.

Fed Redefines Monetary Aggregates

On February 19, 1980, Paul A. Volcker presented to Congress the targets for the monetary aggregates in 1980. These targets were couched in terms of newly defined monetary aggregates: M-1A, M-1B, M-2, and M-3. These 1980 targets, as well as the growth rates for the new aggregates in recent years, are displayed in Table 1 of the statement by Paul Volcker beginning on page 1 of this issue of *Voice*.

The redefinition was prompted by the many financial developments that have altered the meaning and reduced the significance of the old measures. Some of these developments have been associated with the emergence in recent years of new monetary assets—for example, negotiable order of withdrawal (NOW) accounts and money market mutual fund shares—while others have altered the basic character of standard monetary assets—for example, the growing similarity of and the growing substitution between the deposits of thrift institutions and those of commercial banks.

The old and the new

The new M-1A measure is very similar to the old M-1 and differs in excluding demand deposits owned by foreign commercial banks and official institutions. M-1B thus differs from the old M-1 by excluding these deposits, on the one hand, and, on the other, by including other checkable deposits at both commercial banks and thrift institutions.

New M-2 is closer in concept to old M-3, which included savings and time deposit liabilities at all depository institutions (other than negotiable certificates of deposit at large commercial banks), than it is to old M-2, which excluded the public's holdings of savings and time deposits at thrift institutions. The major differences between the new M-2 and old M-3 measures are that the new M-2 includes money market mutual fund shares and overnight repurchase agreements (RP's) and Eurodollars—none of which appeared in any of the old monetary aggregates—and that it excludes all large-denomination time deposits.

By including all large-denomination time deposits at all depository institutions, the new M-3 is closer in concept to the old M-5 measure than to the old M-4. Of course, the new M-3 aggregate is more inclusive than the old M-5 since it contains RP's, certain overnight Eurodollar deposits, and money market mutual fund shares.

Rationale

The organizing principle underlying the redefined monetary aggregates is that of combining similar kinds of monetary assets at each level of aggregation. This principle has the largest impact on the new M-1B, M-2, and M-3 measures.

Two M-1 measures were adopted primarily because of uncertainties that would arise during a transition period, should legislation be enacted that permits NOW accounts to be offered nationwide. NOW accounts have properties of both a transactions-type account and a savings-type account; thus, newly opened NOW accounts would tend to attract funds both from household demand deposits and from savings accounts and other liquid assets. This suggests that during a conversion period associated with nationwide NOW accounts, growth in M-1B could significantly overstate underlying growth in the public's transactions balances. M-1A, by contrast, would tend to understate such growth as households converted demand deposit balances into NOW accounts. In practice, since the extent of shifting from demand deposits or other accounts to NOW accounts is uncertain, the availability of both M-1 measures is expected to help in the interpretation of narrow money stock growth during the transition period, should NOW accounts be offered nationwide.

All three narrow measures of money have generally moved closely together. In recent years, though, M-1B has tended to increase more rapidly than either M-1A or old M-1 because of the growth of NOW accounts and automatic transfer from savings (ATS) accounts.

Over longer periods of time, especially during

NEW MEASURES OF MONEY AND LIQUID ASSETS

(Billions of dollars, not seasonally adjusted)

Aggre- gate	Components	Amount, November 1979
M-1A		\$ 372.2
	Currency	106.6
	Demand deposits ¹	265.6
M-1B		387.9
	M-1A	372.2
	Other checkable deposits ²	15.7
M-2		1,510.0
	M-1B	387.9
	Overnight RP's issued by commercial banks	20.3
	Overnight Eurodollar deposits held by U.S. nonbank residents at Caribbean branches of U.S. banks	3.2
	Money market mutual fund shares	40.4
	Savings deposits at all depository institutions	420.0
	Small time deposits at all depository institutions ³	640.8
	M-2 consolidation component ⁴	-2.7
M-3		1,759.1
	M-2	1,510.0
	Large time deposits at all depository institutions ³	219.5
	Term RP's issued by commercial banks	21.5
	Term RP's issued by savings and loan associations	8.2
L		2,123.8
	M-3	1,759.1
	Other Eurodollars of U.S. residents other than banks	34.5
	Bankers acceptances	27.6
	Commercial paper	97.1
	Savings bonds	80.0
	Liquid Treasury obligations	125.4

1. Net of demand deposits due to foreign commercial banks and official institutions.

2. Includes NOW, ATS, and credit union share draft balances and demand deposits at thrift institutions.

3. Time deposits issued in denominations of less than \$100,000.

4. In order to avoid double counting of some deposits in M-2, those demand deposits owned by thrift institutions (a component of M-1B), which are estimated to be used for servicing their savings and small time deposit liabilities in M-2, are removed.

5. Time deposits issued in denominations of \$100,000 or more.

NOTE: Components of M-2, M-3, and L measures generally exclude amounts held by domestic depository institutions, foreign commercial banks and official institutions, the U.S. Government (including the Federal Reserve), and money market mutual funds. Exceptions are bankers acceptances and commercial paper for which data sources permit the removal only of amounts held by money market mutual funds and, in the case of bankers acceptances, amounts held by accepting banks, the Federal Reserve, and the Federal Home Loan Bank System.

SOURCE: Board of Governors, Federal Reserve System.

economic expansions, growth in new M-2 has been faster than for old M-2. In comparison with old M-3, growth in new M-2 has been moderately slower, except during the most recent economic expansion when sharp increases in money market mutual fund shares and expansion in overnight RP's and Eurodollars contributed to somewhat more rapid growth in new M-2.

Growth rates of new M-3 and old M-5, which are similar in content, have moved closely together, although expansion in new M-3 has generally exceeded that of both of its old counterparts. The disparity between growth in new M-3 and old

M-4 and M-5 widened in the late 1970's with sizable increases in RP's, money market mutual fund shares, and overnight Eurodollars; these items are components of the new M-3 aggregate but were not included in the old M-4 and M-5 aggregates.

Growth in total liquid assets, L, has been similar to—although somewhat steadier than—that of new M-3. In recent years, there has been a tendency for L to grow more rapidly than M-3 and other broad monetary aggregates, reflecting a growing proportion of liquid assets that is being issued outside domestic depository institutions.

Regulatory Briefs and Announcements

Further Regulation E Rules Announced

The Federal Reserve Board has announced the adoption of further final rules to implement the Electronic Fund Transfer Act.

The additional final rules adopted as part of the Board's Regulation E are revisions of proposals published by the Board in October. In general, they deal with:

- Requirements for documentation of electronic fund transfers by financial institutions;
- Notification requirements in connection with preauthorized electronic receipt of funds;
- Requirements for prompt crediting of funds received electronically;
- Procedures for resolving errors;
- Responsibility for compliance when an EFT card or similar device is issued to a consumer by an EFT service provider who does not hold the consumer's account.

The Board decided to take no action at this time on a proposal made in October concerning charges made by financial institutions in connection with error resolution. The Board said it will monitor industry practice regarding such charges and will take action if it becomes evident that consumers need protection in this area.

Board Publishes Glossary

A "Federal Reserve Glossary" that defines terms commonly used in discussing the financial system and monetary policy is now available to the public.

Copies of the pamphlet may be obtained free of charge by contacting Publications Services, Room MP-510, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

Board Calls for Plans to Reduce Float

The Board of Governors of the Federal Reserve System has directed the System's Conference of First Vice Presidents to develop two plans pertaining to the collection of large dollar-value checks. The purpose of both plans is to reduce float.

The first plan would be aimed at the procedures involved in the collection of checks of \$250,000 or more and would require banks to sort out checks of this size before sending checks to the Fed for collection. The second request by the Board calls for completing a plan for electronically transferring information about large dollar-value checks (\$10,000 or more) to the banks on which the checks are drawn.

Both of these plans are designed to speed up check payments and thereby reduce Federal Reserve float, which is averaging about \$5.5 billion daily.

New national member bank

First United Bank, Arlington, N.A., Arlington, Texas, a newly organized institution located in the territory served by the Head Office of the Federal Reserve Bank of Dallas, opened for business February 4, 1980, as a member of the Federal Reserve System. The new member bank opened with capital of \$625,000 and surplus of \$625,000. The officers are: Don Hughes, Chairman of the Board and President; Wanda Hardin, Vice President; Mike Robnett, Vice President and Cashier; and Jean Sanders, Operations Officer.

New state member bank

Clayton State Bank, Clayton, Oklahoma, located in the territory served by the Head Office of the Federal Reserve Bank of Dallas, was admitted February 13, 1980, as a member of the Federal Reserve System. The bank has a capital structure of \$636,000, consisting of capital stock of \$100,000, surplus of \$150,000, and undivided profits and reserves of \$386,000. The officers are: Sam M. Stephens, President and Chairman of the Board; Earnest E. McIntyre, Vice President; Betty Sue Stephens, Vice President; Sam C. S. Stephens, Vice President and Cashier; Janice Stephens, Assistant Cashier; and John Ray Stephens, Assistant Cashier.
