FEDERAL RESERVE BANK OF ST. LOUIS

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REVIEW

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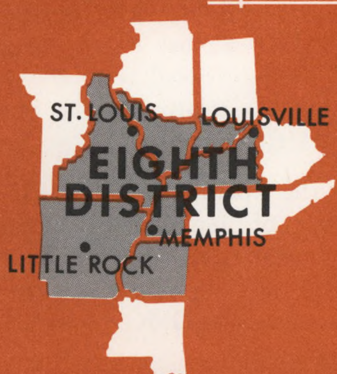

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The FOMC in 1976: Progress Against Inflation

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THE primary objective of monetary policy in 1976 was to reduce inflationary pressures while sustaining the recovery which began in early 1975. The monetary authorities expressed concern that, in an inflationary environment such as prevailed in late-1975 and early-1976, attempts to quicken the pace of economic recovery through stimulative policy actions could yield undesirable results. As expressed by Chairman Burns in February,

> Recent experience . . . suggests that once inflation has become ingrained in the thinking of a nation's businessmen and consumers, highly expansionist monetary and fiscal policies do not have their intended effect . . . they may lead to larger precautionary savings and sluggish consumer buying.[1]

Thus, with the pace of inflation a major concern, the monetary authorities began the year with ". . . the firm intention of staying with a course of moderation in monetary policy."[2]

On balance, over 1976 the money stock (M_1) grew 5.5 percent, a rate that was "moderate," at least by comparison with the growth rates of money experienced since the early 1970s. The growth rate of money did not sharply reaccelerate this second year of economic recovery, as it had in some previous recovery periods. When the money stock accelerated sharply, as in April and May, the Federal Open Market Committee (FOMC) adopted a more restrictive policy and the growth of M_1 fell back. Associated with this policy were falling interest rates and strong growth of deposits at thrift institutions. There was no increase in the trend growth of money — the major influence on the trend growth of prices — and the stage was set for a possible reduction in the trend growth of M_1 in 1977.

In 1976, for the second consecutive year, the FOMC publicly announced longer-run ranges for the major monetary aggregates, M_1, M_2, and M_3. The policy of announcing longer-run ranges was begun in early 1975 at the request of Congress as expressed in House Concurrent Resolution 133 passed on March 24, 1975. This resolution requested that the Board of Governors consult with Committees of the Congress on a quarterly basis with respect to its objectives and plans for the ranges of growth of the monetary aggregates over the next twelve months.[3]

During 1976 Chairman Burns met with Congressional Committees at about 90 day intervals to present the intended longer-run growth rates for the monetary aggregates that had been decided upon at the FOMC meeting about 15 days earlier. These yearly ranges were based on the quarterly average for the most recent quarter to the quarterly average for one year in the future. The Federal Reserve repeatedly emphasized that targets of this nature must be subject to review and administered with flexibility.

The FOMC in 1976 also decided to release its short-run operating targets for the monetary aggregates and the Federal funds rate with a shorter delay than had previously been the case. The "Record of Policy Actions" for each FOMC meeting contains the short-run operating targets for the monetary aggregates and the Federal funds rate. From mid-1967 to early 1975 there had been a delay of about 90 days in releasing the "Record" for each FOMC meeting. In early 1975 this interval was shortened to 45 days. At the May 18, 1976 FOMC meeting the Committee voted to release this record with a delay of only about a month.

The extent to which the Federal Reserve was holding the growth of the aggregates within the announced longer-run ranges was subject to very close scrutiny by Congress and the public. Whereas in previous years the behavior of M_1 was considered significant by some, in 1976 almost every financial report and the bulk of Congressional testimony was devoted to movements in M_1 relative to the ranges announced by the FOMC.

This article reviews the operation of the FOMC during this second year of announced longer-run ranges of growth for monetary aggregates. A Supplement at the end of the article presents a detailed meeting-by-meeting summary of FOMC decisions.

NOTE: Unless otherwise stated citations throughout this paper are from either the "Record of Policy Actions of the Federal Open Market Committee" or "Statements to Congress," Federal Reserve *Bulletin* (February 1976-February 1977).

[1]"Statements" (March 1976), p. 233.

[2]Arthur F. Burns, "Statements" (February 1976), p. 112.

[3]See Nancy Jianakoplos, "The FOMC in 1975: Announcing Monetary Targets," this *Review* (March 1976), pp. 9-10.

Table I

FOMC Operating Ranges 1975-1976

Short-Run Tolerance Ranges[1]

Date of Meeting	Federal Funds Rate	RPD[2]	Period to which M1 & M2 Ranges Apply	Ranges Specified M1	Ranges Specified M2	Actual Growth Rates M1	Actual Growth Rates M2
December 16, 1975	4½-5½%	4-7%	Dec.-Jan.	4-7%	7-10%	6.8%	11.0%
January 20, 1976	4¼-5	2-7	Jan.-Feb.	4-9	7-11½	4.1	12.6
February 17-18, 1976	4¼-5¼	(−½)-(−4½)	Feb.-Mar.	5-9	9-13	5.7	11.0
March 15-16, 1976	4¼-5¼	(− 2)-(+2)	Mar.-Apr.	4-8	7-11	10.1	11.0
April 20, 1976	4½-5¼		Apr.-May	4½-8½	8-12	10.9	11.5
May 18, 1976	5-5¾		May-June	4-7½	5- 9	2.8	6.6
June 22, 1976	5¼-5¾		June-July	3½-7½	6-10	3.0	8.2
July 19-20, 1976	4¾-5¾		July-Aug.	4-8	7½-11½	6.1	10.6
August 17, 1976	5-5½		Aug.-Sept.	4-8	7½-11½	3.1	9.6
September 21, 1976	4¾-5½		Sept.-Oct.	4-8	8-12	7.4	13.0
October 19, 1976	4½-5¼		Oct.-Nov.	5-9	9-13	6.8	13.0
November 16, 1976	4½-5¼		Nov.-Dec.	3-7	9½-13½	4.1	11.4
December 20-21, 1976	4¼-5		Dec.-Jan.	2½-6½	9-13	6.8	11.0

Longer-Run Tolerance Ranges[3]

Date Announced	Target Period	M1	M2	M3	Credit Proxy[4]
November 4, 1975	III/75-III/76	5-7½%	7½-10½%	9-12%	6-9%
February 3, 1976	IV/75-IV/76	4½-7½	7½-10½	9-12	6-9
May 3, 1976	I/76-I/77	4½-7	7½-10	9-12	6-9
July 27, 1976	II/76-II/77	4½-7	7½- 9½	9-11	5-8
November 11, 1976	III/76-III/77	4½-6½	7½-10	9-11½	5-8

[1]Short-run tolerance ranges were adopted at each of the FOMC's regularly scheduled meetings. The ranges for the monetary and reserve aggregates were specified in terms of two-month simple annual rates of change from the month prior to the meeting at which the ranges were established to the month following the meeting. The ranges for the Federal funds rate were specified to cover the period from the meeting at which the ranges were adopted to the following regularly scheduled meeting. Short-run ranges were made available in the "Record of Policy Actions of the Federal Open Market Committee" approximately 30 days after each meeting.

[2]At a special meeting held on March 29, 1976, the Committee reached the understanding that several reserve aggregates (including nonborrowed reserves, total reserves, and "monetary base" — total reserves plus currency) should be considered in formulating their instructions to the Manager of the System Open Market Account. Hence, the Committee agreed to no longer specify expected growth rates for reserves available to support private nonbank deposits (RPD's).

[3]Chairman of the Federal Reserve Board Arthur F. Burns announced intended growth rates of monetary aggregates over the indicated one year periods in statements presented before Congressional Committees at intervals of approximately 90 days.

[4]Daily average member bank deposits, adjusted to include funds from nondeposit sources.

Aggregate Targets

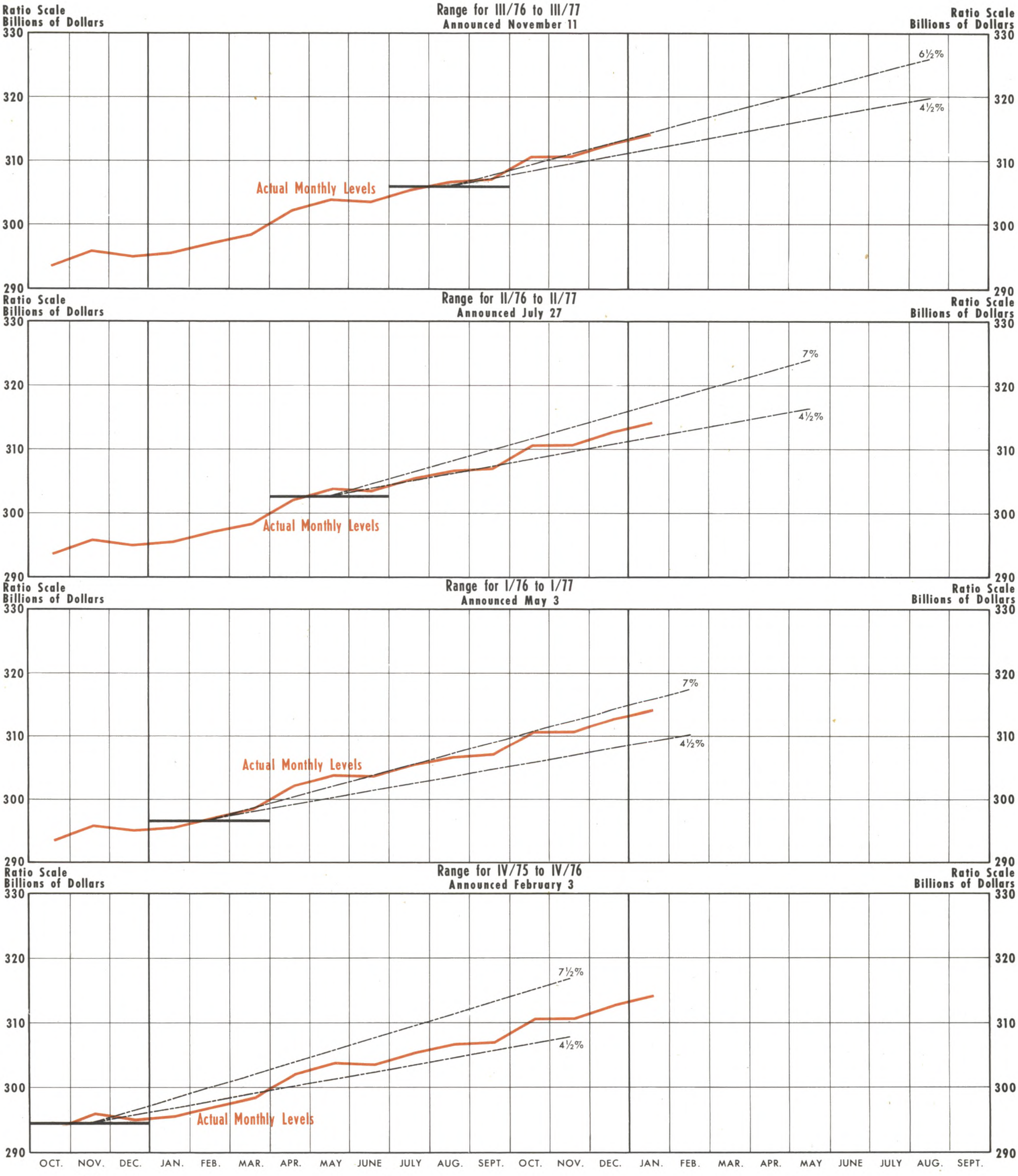
The FOMC decided upon both longer-run and short-run ranges for the monetary aggregates. These ranges for 1976 are presented in Table I, and the longer-run ranges are shown graphically in Chart I. The longer-run ranges cover a period of one year, stretching from the most recent quarter to the corresponding quarter one year in the future. These longer-run ranges were reviewed by the FOMC at the end of each quarter, and were subject to modification at any time based on new information about the likely course of the economy. Therefore, as members of the FOMC have repeatedly pointed out, the FOMC does not consider itself "locked in" to previously announced growth ranges for the whole year period. Monetary targets are expressed as ranges, rather than single numbers.

Once basic decisions have been made about rates of money growth, problems arise concerning the manner of specifying the targets. There is the choice between a single number and a range. A single number virtually guarantees a miss but by virtue of that fact also provides a reasonable excuse for missing. The uncompromising character of a single-number target, however, is also more apt to provoke controversy. A target range is easier to hit but, by the same token, a miss may be more severely criticized. At the same time, a range is likely to be less controversial because it is less specific.[4]

[4]Henry C. Wallich, "Innovations in Monetary Policy" (paper presented at the Southern Economic Association meeting, Atlanta, Georgia, November 18, 1976), p. 7.

Chart I

Twelve-Month M_1 Tolerance Ranges Announced During 1976



Note: The longer-run ranges and actual M_1 levels represent the most current seasonally adjusted monthly data.

The FOMC also chooses short-run ranges for the monetary aggregates that are thought to be consistent with longer-run ranges. These short-run ranges are specified over moving 2-month periods. For example at the January meeting the FOMC specified short-run operating targets for the 2-month period January-February. Then at the February meeting, new targets were set for the February-March period. Also, at each monthly meeting the FOMC sets desired ranges for the Federal funds rate that cover the period until the next meeting. The funds rate range is chosen to be broadly consistent with the short-run ranges for the aggregates. On a meeting-to-meeting basis, control of the funds rate becomes the primary operating objective of the Trading Desk.

Longer-Run Ranges — The FOMC began 1976 operating with longer-run ranges of 5 - 7½ percent for M_1 and 7½ - 10½ percent for M_2. These ranges, which had been announced in November 1975, covered the period from third quarter 1975 to third quarter 1976. At its January meeting the FOMC reviewed its longer-run ranges and decided to reduce the lower range in M_1 growth from 5 to 4½ percent for the period from fourth quarter 1975 to fourth quarter 1976. After announcing the new longer-run range to Congress, Chairman Burns further stated that ". . . the growth rates of money and credit presently desired by the Federal Reserve cannot be maintained indefinitely without running a serious risk of releasing new inflationary pressures."[5]

Throughout 1976 the FOMC's longer-run ranges for M_1 growth were further reduced. In the first quarter of 1976 M_1 grew at only a 2.9 percent annual rate, considerably below the lower range of 4½ percent. However, real output growth had been very strong in the first quarter and staff projections indicated that prices would rise more rapidly during the remainder of the year. At the April meeting,

> It was stressed during the discussion that the rate of growth in M1 needed to accommodate a good economic recovery had been overestimated earlier: Although M1 growth in the past two quarters had fallen short of the lower limit of the range that had been specified by the Committee, it obviously had been sufficient to accommodate a strong recovery.[6]

Therefore, the FOMC voted to reduce the upper range on growth of M_1 from 7½ to 7 percent.

> It was noted that the recovery in economic activity had been under way for 1 year and that the end of the new period for the growth ranges would fall 2 years after the recession trough. Moreover, the recovery recently had gained strength. Accordingly, it was observed that this might be an opportune time for the Committee to take a small step toward its longer-range objective of returning growth in the monetary aggregates toward rates consistent with general price stability.[7]

Although real output growth slowed substantially in the second quarter of 1976, the FOMC decided at its July meeting to retain its longer-run ranges for money growth. In reaching the decision to maintain the previous one-year range for M_1, the Committee noted that even with the second quarter slowing in the rate of economic expansion, real output had increased at about a 7 percent annual rate over the first half of the year. "A staff analysis of the economic outlook suggested that the advance in business activity would soon improve from the relatively slow pace of recent months."[8] Staff projections suggested a "moderately rapid pace" for output growth over the next two quarters, and favorable prospects for ". . . continuation of a good rate of expansion in real output into 1977."[9] Since the outlook for economic activity was generally viewed as favorable, there was some sentiment among members of the FOMC to lower the longer-run range for M_1. However, the Committee concluded that

> . . . this did not appear to be an appropriate time to reduce the [longer-run target] range [for M1 growth] in view of the recent hesitation in the course of the economic expansion.[10]

During the third quarter the FOMC continued to be satisfied with the pace of economic activity and expected a halt to the temporary "pause" and some pick up in the growth of real output later in 1976. At the Committee's August meeting,

> Staff projections continued to suggest that real GNP would expand at a moderate pace in the current quarter and that moderate growth in output would continue well into 1977.
>
> Staff projections for the second half of 1976 differed little from those of 4 weeks earlier; they continued to suggest that the slackening in economic growth in recent months would prove to be temporary.
>
> In general, Committee members felt that the pace of expansion in over-all economic activity would soon pick up again.[11]

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[5]"Statements" (February 1976), pp. 124-25.

[6]"Record" (June 1976), p. 517.

[7]Ibid., pp. 516-17.

[8]"Record" (September 1976), p. 776.

[9]Ibid., p. 774.

[10]Ibid., p. 781.

[11]"Record" (October 1976), pp. 837, 839-40, and 844.

EXHIBIT I

FOMC ECONOMIC POLICY DIRECTIVES — 1976

Date of FOMC Meeting	Policy Consensus	Operating Instructions	Dissents
January 20	. . . to foster financial conditions that will encourage continued economic recovery, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.	. . . while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.	None
February 17-18	No Change	No Change	None Absent and not voting: Mr. Gardner.
March 15-16	No Change	. . . while taking account of developments in domestic financial markets and the sensitive state of foreign exchange markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.	None
April 20	No Change	. . . while taking account of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.	None Absent and not voting: Mr. Holland.
May 18	No Change	No Change	Mr. Coldwell dissented because he did not want to provide for the possibility of a rise of as much as ½ percentage point in the Federal funds rate . . . . In his opinion, a further rise of that amount could have an exaggerated effect on expectations in the financial markets, provoking excessive increases in interest rates.
June 22	. . . to foster financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.	No Change	None Absent and not voting: Mr. Kimbrel. (Mr. Baughman voted as alternate for Mr. Kimbrel.)

July 19-20	No Change	No Change	Mr. Volker dissented from this action because in the present circumstances he would not wish to raise or lower the Federal funds rate by as much as ½ of a percentage point — a change that might be interpreted as a strong signal of a change in policy and that could have repercussions in financial markets — in response merely to short-term fluctuations in the monetary aggregates that might well prove transient.
August 17	No Change	. . . while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.	None Absent and not voting: Mr. Balles. (Mr. Guffey voted as alternate for Mr. Balles.)
September 21	No Change	. . . while taking account of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.	None Absent and not voting: Mr. Partee
October 19	No Change	No Change	None
November 16	No Change	No Change	None Absent and not voting: Mr. Balles. (Mr. Guffey voted as an alternate for Mr. Balles.)
December 20-21	No Change	. . . while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.	None

This view was again expressed by the FOMC in September:

> Staff projections suggested that growth in real GNP would pick up somewhat in the fourth quarter and would remain at a good rate well into 1977.
>
> Staff projections for the period through the second quarter of 1977 suggested that growth in real output of goods and services would be at a somewhat higher rate than in the second and third quarters of 1976.
>
> During the Committee's discussion of the economic situation at this meeting no member expressed substantial disagreement with the staff projection of stronger growth in real GNP over the quarters immediately ahead.[12]

At the October 19 FOMC meeting the preliminary estimates of growth in real GNP showed a further slowing to about a 4 percent rate in the third quarter of 1976 from the 4.5 rate recorded in the second quarter. The FOMC, although somewhat concerned about the slower than anticipated growth of real GNP, expected some improvement in real output growth in the future and retained their serious concern about inflation.

> Staff projections continued to suggest that growth in real GNP would pick up somewhat in the fourth quarter and would be sustained at about the fourth-quarter rate well into 1977.
>
> No member suggested that a decline in economic activity was likely, but some of the members expressed concern that the rate of growth in coming quarters would not achieve a sufficient reduction in unemployment. Serious concern was also expressed by various members about the persistence of a high rate of inflation.[13]

At the October meeting the longer-run ranges were discussed, but since it would be 23 days before Chairman Burns testified before Congress, the FOMC decided to postpone its decision on the appropriate ranges from third quarter 1976 to third quarter 1977 until early November. On November 8 the Committee held a telephone conference meeting where it was decided to lower the upper range on M_1 from 7 to 6½ percent. The Committee decided that such a range ". . . would provide ample scope for faster monetary growth, while still seeking a gradual return to general price stability."[14] Consequently, the FOMC was operating at the end of 1976 with an upper target boundary for M_1 growth that was one full percentage point lower than at the end of 1975.

The FOMC also made some downward adjustments in its target ranges for the broader monetary aggregate M_2. These adjustments were less marked than those in the M_1 ranges. The lower band of the M_2 range was left unchanged at 7½ percent throughout 1976. The upper band was reduced at the April meeting by ½ percentage point, and then was further reduced by ½ percentage point at the July meeting. However, in November when the upper band of the M_1 target range was lowered, the upper band on the M_2 range was raised ½ percentage point. This upward adjustment in the M_2 target range was made because:

> Expansion in the types of time and savings deposits included in the broader aggregates had been larger than expected mainly because short-term market interest rates had proved to be lower than anticipated while rates offered by bank and nonbank thrift institutions had remained generally at regulatory ceilings. Under such circumstances, it was observed, it would be appropriate to accommodate higher rates of growth in M2 and M3 than contemplated in July, if they should develop.[15]

Short-Run Ranges — At each of its monthly meetings the FOMC decided upon short-run ranges for M_1, M_2, and the Federal funds rate that were thought to be consistent with the longer-run goals of policy. Because of the sharp month-to-month variation in the growth rates of the monetary aggregates, the FOMC has (1) stated its short-run objectives in terms of average growth rates over two-month periods and (2) specified much wider short-run ranges for the growth rates of the aggregates than longer-run ranges. The two-month periods cover the month in which the meeting is held and the following month. The short-run ranges, as shown in Table I, were usually about 4 percentage points in width.

The short-run implementation of policy remained, as it had been in the past, keyed to control of the Federal funds rate.

> The Federal Reserve policy strategy is based in large part on the monetary aggregates, but its short-run tactical instrument is the Federal funds rate. Under the funds rate approach, the Federal Reserve estimates the level of short-term interest rates, including the funds rate, at which the public, given projections of income, will want to hold the amount of money the Federal Reserve intends to supply. Then reserves are supplied in an amount that will maintain that level of the funds rate, and that will cause the banks to generate the targeted amount of money.[16]

[12]"Record" (November 1976), pp. 916, 919, and 922.

[13]"Record" (December 1976), pp. 1019 and 1025.

[14]Ibid., p. 1031.

[15]Ibid., pp. 1031-32.

[16]Wallich, "Innovations in Monetary Policy," p. 12.

Organization of the Committee in 1976

The Federal Open Market Committee (FOMC) consists of the seven members of the Federal Reserve Board of Governors and five of the twelve Federal Reserve Presidents. The Chairman of the Board of Governors is also, by tradition, Chairman of the Committee. The President of the New York Federal Reserve Bank is a permanent member of the Committee and, also by tradition, its Vice Chairman. All other Federal Reserve Bank Presidents attend the meetings and present their views, but only the four Presidents who are members of the Committee may cast votes. These four memberships rotate among the Bank Presidents and are held for one-year terms beginning March 1.

Members of the Board of Governors in 1976 included Chairman Arthur F. Burns, Vice Chairman Stephen S. Gardner, Philip E. Coldwell, Philip C. Jackson, Jr., David M. Lilly, J. Charles Partee, and Henry C. Wallich. Mr. Gardner succeeded George W. Mitchell, whose term expired January 31, as Vice Chairman of the Committee effective February 13. Mr. Lilly assumed his duties June 1, replacing Robert C. Holland who resigned effective May 15. In addition to Paul A. Volcker, President of the Federal Reserve Bank of New York, the following Presidents served on the Committee during January and February 1976: Ernest T. Baughman (Dallas), David P. Eastburn (Philadelphia), Bruce K. MacLaury (Minneapolis), and Robert P. Mayo (Chicago). In March the Committee was reorganized and the four rotating positions were filled by: John J. Balles (San Francisco), Robert P. Black (Richmond), Monroe Kimbrel (Atlanta), and Willis J. Winn (Cleveland).

The Committee met regularly once each month during 1976 to discuss, among other things, economic trends and to decide upon the future course of open market operations.[1] However, as in previous years, occasional telephone or telegram consultations were held between scheduled meetings.[2] During each regularly scheduled meeting, a directive was issued to the Federal Reserve Bank of New York stating the general economic goals of the Committee and providing general guidelines as to how the Manager of the System Open Market Account at the New York Federal Reserve Bank should conduct open market operations to achieve these goals. Each directive contained a short review of economic developments and the general economic goals sought by the Committee. The last paragraph gave operating instructions to the Account Manager. These instructions were stated in terms of bank reserve and money market conditions which were considered consistent with the achievement of desired growth rates of monetary aggregates. Special factors, such as Treasury financing operations, were also taken into account.

Decisions regarding the exact timing and amount of daily buying and selling of securities in fulfilling the Committee's directive are the responsibility of the System Open Market Account Manager at the Trading Desk of the New York Bank. Each morning, the Account Manager and his staff decide on a plan for open market operations to be undertaken that day. In developing this plan, money and credit market conditions and aggregate targets desired by the Committee are considered, as well as other factors which may be of concern at the time. Each morning, the Account Manager, in a conference call, informs one voting President and staff members of the Board of Governors about present market conditions and open market operations which he proposes to execute that day. Other members of the Committee are informed of the daily program by wire summary.

A summary of the Committee's actions is presented to the public in the "Record of Policy Actions of the Federal Open Market Committee." Following the Committee's decision at the May 18, 1976 meeting, the "Record" was released approximately 30 days after each meeting, beginning with the "Record" of the April 20, 1976 meeting. Soon after it is released, the "Record" appears in the Federal Reserve *Bulletin* and, in addition, "Records" for the entire year are published in the *Annual Report of the Board of Governors*. The "Record" for each meeting during 1976 generally included:

1) a staff summary of recent economic developments, such as prices, employment, industrial production, and components of the national income accounts; projections concerning real output growth for two or three quarters ahead; and prospective financial developments;

2) a discussion of recent international financial developments and the U. S. foreign trade balance;

3) a discussion of credit market conditions and recent interest rate movements;

4) a discussion of open market operations, the growth of monetary aggregates, and bank reserve and money market conditions since the previous meeting;

5) a discussion of current policy considerations, including money market conditions and the movements of monetary aggregates;

6) conclusions of the FOMC;

7) a policy directive issued by the Committee to the Federal Reserve Bank of New York;

8) a list of the members' voting positions and any dissenting comments;

9) a description of any actions and consultations that may have occurred between the regularly scheduled meetings.

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[1]The Committee held a special meeting on March 29, 1976 for the purpose of reappraising the methods employed in formulating and implementing the directives issued to the Manager of the System Open Market Account.

[2]On November 8, 1976 the Committee held a telephone meeting for the purpose of establishing monetary aggregate growth ranges over the year ending third quarter 1977.

Periodically during 1976 primary importance was assigned to control of the Federal funds rate as an operating target. For example, money market conditions received primary emphasis at the January, August, and December meetings:

> In view of the current uncertainties regarding the behavior of the monetary aggregates, many members advocated that the Committee continue to give greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting and that it specify 2-month ranges of tolerance for growth in the monetary aggregates that were wider than usual.[17]

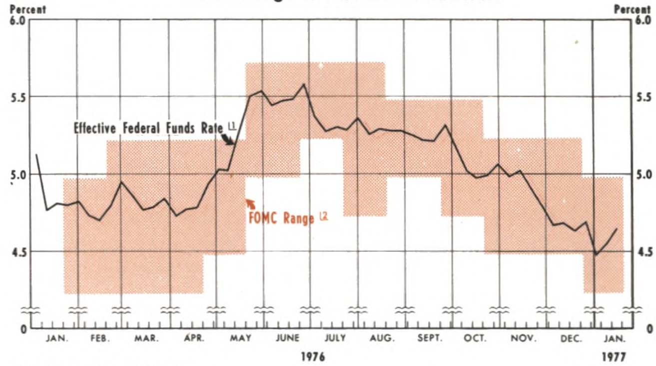
> Most members favored directing operations toward maintaining about the current Federal funds rate. Accordingly, they preferred to give more weight than usual to money market conditions in formulating the operating instructions contained in the last paragraph of the domestic policy directive, and they advocated specifying a relatively narrow range for the Federal funds rate centered on the prevailing rate of 5¼ per cent.[18]

> Most members favored giving greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting, in part because projections of growth in monetary aggregates around the year-end were highly uncertain.[19]

As shown in Chart II and Table I, the Federal Reserve in 1976 consistently held the Federal funds rate within its short-run target ranges, usually at about the mid-point of the target ranges. Even though the two-month growth targets for the aggregates were specified with wide ranges, the actual growth rates of the aggregates were frequently above or below the specified ranges, as shown in Chart III. However, as noted at the January meeting, "It was . . . understood [by the FOMC] that, as a result of short-run factors, growth rates from month to month might well fall outside the ranges contemplated for annual periods."[20] At each meeting the FOMC reviewed the short-run behavior of the aggregates relative to their expected behavior. When the aggregates were growing above their expected ranges, the FOMC in 1976 generally raised its short-run specification for the Federal funds rate. For example, the growth of M_1 accelerated rapidly in April and May. At the April meeting the FOMC voted to raise the lower band on the funds rate by 25 basis points.

Chart II

FOMC Range for Federal Funds Rate



1 Weekly averages of daily rates.
2 At each regularly scheduled meeting during 1976 the FOMC established a range of tolerance for the Federal funds rate. These ranges are indicated for the first full week during which they were in effect.

> In view of their assessment that the pace of economic expansion would be relatively strong, most members favored directing operations in the period immediately ahead toward restraining growth of the monetary aggregates within ranges not very much higher than the longer-run ranges agreed upon at this meeting and indicated that they would tolerate some modest firming in money market conditions. It was observed that some firming in money market conditions in this period would reduce the likelihood of excessive monetary growth in subsequent months.[21]

Then at the May 18 meeting,

> The members agreed that growth in monetary aggregates recently had been at unacceptably high rates, especially in view of the longer-run ranges for growth that had been adopted at the preceding meeting.

> . . . to sustain confidence it was important for the System to demonstrate its intention to resist unduly rapid growth in the monetary aggregates; and that pursuit of that objective would run little or no risk of aborting the recovery in economic activity.

> In general, Committee members favored directing operations in the period immediately ahead toward moderating growth of the monetary aggregates, and they indicated that in pursuit of that end they would accept some modest further firming in money market conditions.[22]

Consequently, the FOMC adopted a Federal funds range of 5-5¾ percent, compared to the 4½ - 5¼ percent range adopted in April.

Mr. Coldwell dissented from the Committee's decision at the May meeting to raise the Federal funds rate range by ½ percent. An increase in the funds rate of as much as ½ percent over the next inter-meeting

17"Record" (March 1976), p. 243.

18"Record" (October 1976), p. 845.

19"Record" (February 1977), p. 137.

20"Record" (March 1976), p. 243.

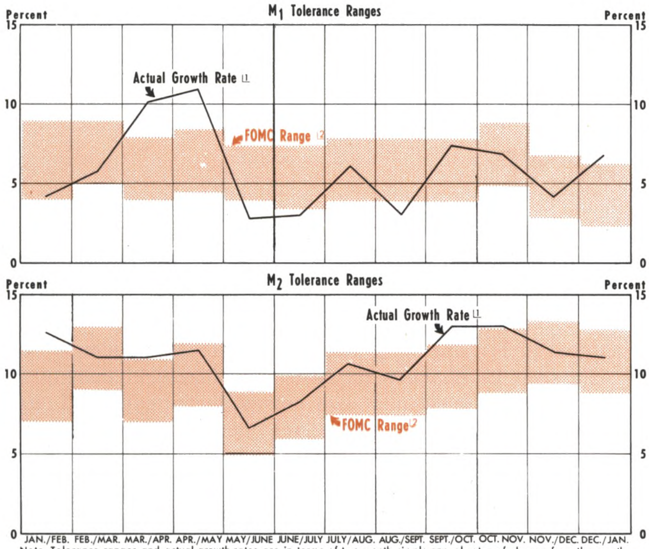
21"Record" (June 1976), p. 518.

22"Record" (July 1976), pp. 586-87.

Chart III

FOMC Ranges of Tolerance for Monetary Aggregates

1976



Note: Tolerance ranges and actual growth rates are in terms of two-month simple annual rates of change from the month prior to the meeting at which the ranges were adopted to the month following the meeting.

[1] Actual growth rates are based on the most current seasonally adjusted monthly data.

[2] The shaded areas represent two-month ranges adopted by the Comittee at each regularly scheduled meeting. The ranges are shown for the periods over which they were specified to apply.

period, in Mr. Coldwell's opinion, ". . . could have an exaggerated effect on expectations in the financial markets, provoking excessive increases in interest rates."[23]

As the summer progressed it became evident that money growth was low relative to the short-run targets. The Desk operated in early July to reduce the Federal funds rate to its lower band of 5¼ percent established at the June FOMC meeting. At the July FOMC meeting the lower band on the funds rate was lowered ½ percentage point to 4¾ percent.

Mr. Volker dissented from the Committee's action at this meeting. In his view, allowing a change in the Federal funds rate of as much as ½ percentage point in response to short-run variations in monetary aggregates ". . . might be interpreted as a strong signal of a change in policy and that could have repercussions in financial markets. . . ."[24]

The gradual reduction in the Federal funds rate continued throughout the rest of 1976. By the end of the year the range on the Federal funds rate had been reduced to 4¼ to 5 percent. At the August FOMC meeting the Desk was directed to aim for a funds rate of 5¼ percent, and this directive was continued at the September meeting. At the October meeting, in view of the slow growth of the monetary aggregates, the Desk was initially directed to aim for a 4⅞ percent funds rate. This was later raised to 5 percent as there appeared evidence of renewed strength in the aggregates.

At the November FOMC meeting it appeared that real output was currently expanding at an even slower rate than the 4 percent preliminary estimate for the third quarter. Members of the FOMC were generally agreed that the pause in real output growth was still in force. The Committee was concerned that near-term real output growth would not be adequate to make any progress toward reducing the unemployment rate. Consequently, the FOMC decided to ease money market conditions at the November meeting.

> In the discussion of current policy at this meeting, members of the Committee in general favored some easing in money market conditions in the period immediately ahead, so long as growth in the monetary aggregates did not appear to be unduly rapid.[25]

> . . .System operations were conducted pursuant to the Committee's decision that the Manager should aim to reduce the Federal funds rate to about 4⅞ per cent within the first week after the meeting and to 4¾ per cent within the following week — provided that growth in the monetary aggregates did not appear to be strong relative to the specified ranges.[26]

In November and early December the projections for the growth of M_1 and M_2 over the November-December period were revised downward. By early December it appeared that M_1 growth might fall below its lower short-run target band. The Desk became "somewhat more accommodative in the provision of reserves" and by the time of the December 20 FOMC meeting the Federal funds rate was at about 4⅝ percent.

Summary and Conclusions

The FOMC began 1976 with the firm intention of avoiding a reacceleration of inflation while continuing to encourage economic recovery. In pursuit of this policy, throughout the year the FOMC moved to gradually reduce its longer-run ranges for the growth rate of the money stock (M_1). Although these ranges were reduced, the actual growth rate of the money stock was only reduced slightly, compared to its rate during the first three quarters of the current economic recovery. M_1, which had grown at a 5.6 percent rate from the first quarter of 1975 to the fourth quarter of 1975,

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[23] Ibid., p. 589.

[24] "Record" (September 1976), p. 786.

[25] "Record" (January 1977), p. 23.

[26] "Record" (February 1977), p. 133.

continued to grow at the same rate over the first two quarters of 1976. Over the last half of 1976, the growth of money was reduced slightly to 5.4 percent. Although the actual growth rate of money was hardly reduced over 1976, relative to its past trend of about 6 percent it grew at a somewhat slower rate. By thus avoiding a reacceleration in money growth the FOMC made a first step toward reducing inflation.

SUPPLEMENT

FOMC Decisions in 1976

This supplement consists of selected excerpts from the "Record of Policy Actions" for each of the FOMC meetings in 1976. The excerpts are selected to highlight key factors influencing FOMC decisions. They include analyses of current and projected economic developments, discussions of current policy actions, and long- and short-run operating instructions issued by the FOMC to the Trading Desk. The full text of each "Record of Policy Actions" appears in issues of the Federal Reserve *Bulletin*.

Meeting Held on January 20, 1976

Staff projections suggested that growth in output would moderate somewhat further in the first half of 1976 and that the rate of increase in prices would change little.

System open market operations in the inter-meeting period had been guided by the Committee's decision to maintain the bank reserve and money market conditions prevailing at the time of the December meeting, provided that monetary aggregates appeared to be growing at about the rates then expected. Data that became available week by week after the December meeting suggested that in the December-January period M1 and M2 would grow at rates below the lower limits of the ranges of tolerance that had been specified by the Committee. Accordingly, near the end of December, the System began to direct operations toward some easing in bank reserve and money market conditions. By January 12 the Federal funds rate had declined from the neighborhood of 5¼ per cent — the level prevailing at the time of the December meeting — to an area of 4¾ to 4⅞ per cent.

Subsequently, a majority of Committee members concurred in Chairman Burns' recommendation of January 12 that the Manager be instructed to hold the weekly-average Federal funds rate at the approximate level of 4¾ per cent until the time of this meeting.

. . .part of the fourth-quarter shortfall in growth of M1 appeared to be attributable to a decline in the demand for checking deposits, especially because of the shift in business deposits from demand accounts to savings accounts. Businesses were expected to continue to substitute savings accounts for demand deposits over the year ahead, although at a slower pace than in recent weeks. For that reason, and also because of other indications that demand deposits were being used more efficiently, the Committee decided to reduce the lower limit of the longer-run range specified for M1 from 5 per cent to 4½ per cent.

The ranges specified for M2 and M3 . . . were unchanged from those adopted in October.

In the discussion of current policy at this meeting, the Committee took note of a staff analysis suggesting that for the period immediately ahead uncertainty about the behavior of the demand for money was greater than usual.

In view of the current uncertainties regarding the behavior of the monetary aggregates, many members advocated that the Committee continue to give greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting and that it specify 2-month ranges of tolerance for growth in the monetary aggregates that were wider than usual. Some members preferred to give greater emphasis to variations in the behavior of the monetary aggregates relative to expectations, and the suggestion was also made that more weight be given to the behavior of M2 relative to that of M1 than had been the case in the past.

Meeting Held on February 17-18, 1976

Staff projections for the second quarter of this year suggested that growth in output would remain moderate and that the rate of increase in prices would change little.

Staff projections for the first half of 1976 suggested that growth in real output would be somewhat stronger than had been suggested 4 weeks earlier.

System open market operations in the inter-meeting period had been guided by the Committee's decision to maintain the bank reserve and money market conditions prevailing at the time of the January meeting, provided that monetary aggregates appeared to be growing at about the rates then expected. Data that became available week by week suggested that in the January-February period M1 would grow at a rate near the lower limit of the range of tolerance that had been specified by the Committee but that M2 would grow at a rate near the upper limit of its range of tolerance. Therefore, operations were directed toward maintaining the Federal funds rate close to 4¾ per cent, the level prevailing at the time of the January meeting.

In the discussion of current policy at this meeting, the Committee took note of a staff analysis suggesting that in the period immediately ahead transactions demands for money — at current levels of short-term interest rates — might be expected to pick up in association with expansion in economic activity.

During the discussion it was noted that the economic situation and outlook had improved in recent weeks, and almost all Committee members indicated that they favored essentially no change in policy.

Meeting Held on March 15-16, 1976

Staff projections for the second quarter of 1976 were similar to those of 4 weeks earlier.

System open market operations in the inter-meeting period had been guided by the Committee's decision that open market operations should be directed toward maintaining the bank reserve and money market conditions prevailing at the time of the February meeting — characterized by a Federal funds rate of about 4¾ per cent — provided that monetary aggregates appeared to be growing at about the rates then expected.

Data that became available near the end of February suggested that both M1 and M2 were growing faster than had been expected, and open market operations permitted a slight firming in bank reserve and money market conditions. However, data that became available toward the end of the first week in March suggested that the monetary aggregates were growing at rates closer to those that had been originally expected, and money market conditions eased.

In the discussion of current policy at this meeting, the Committee took note of a staff analysis suggesting that in the period immediately ahead transactions demands for money — at current levels of short-term interest rates — might be expected to increase in association with expansion in nominal GNP; in view of recent experience, however, the analysis also suggested that the increase might be less than would be expected on the basis of historical relationships.

During the discussion it was noted that the recovery in economic activity had remained orderly, that liquidity had improved, and that the outlook for activity was satisfactory — although inflation remained a problem. Against that background, Committee members indicated that they favored essentially no change in policy.

Meeting Held on April 20, 1976

Staff projections for the remaining quarters of this year suggested that growth in output would be moderate and that the rise in prices would be above the relatively low first-quarter pace.

System open market operations since the March 15-16 meeting had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead. Data that became available week by week during the inter-meeting period suggested that in the March-April period M1 and M2 would grow at rates near the midpoints of the ranges that had been specified by the Committee. Accordingly, System operations were directed toward maintaining conditions of reserve availability consistent with a Federal funds rate of about 4¾ per cent — the rate prevailing at the time of the March meeting and the midpoint of the operating range that the Committee had specified for the inter-meeting period.

During the discussion, the view was expressed that an appreciable tightening in money market conditions in the period immediately ahead would be premature. . . .

. . . financial markets were particularly sensitive at this time, and any appreciable tightening in money market conditions could have a substantial effect on short-term interest rates and could adversely affect flows of time and savings deposits at both banks and nonbank thrift institutions.

Meeting Held on May 18, 1976

Staff projections suggested that growth in real output was continuing at a vigorous, although slightly less rapid, pace in the current quarter and that it was likely to be more moderate in the second half of the year. The projections also suggested that the rise in prices would be above the relatively low first-quarter rate.

Immediately after the April meeting the System became less accommodative in the provision of reserves. Operations were directed toward achieving conditions of reserve availability consistent with a Federal funds rate of 4⅞ per cent — the midpoint of the 4½ to 5¼ per cent operating range that the Committee had specified for the inter-meeting period and ⅛ percentage point above the rate prevailing at the time of the April meeting.

Data that had become available soon after that meeting and in each subsequent week suggested that in the April-May period growth in M1 and M2 would be strong relative to the ranges that had been specified by the Committee. Accordingly, the System gradually became still less accommodative in the provision of reserves. By the end of the inter-meeting period the Federal funds rate was around 5¼ per cent, the upper limit of the specified range. . . .

In the discussion of current policy at this meeting, the Committee took note of a staff analysis suggesting that over the May-June period the rate of growth in M1 was likely to subside from the rapid pace in April. . . .

During the Committee's discussion, it was observed that the recovery in economic activity had proceeded in a satisfactory way, although the rate of unemployment remained high and re-intensification of inflationary pressures was a serious threat.

Altogether, the outlook for economic activity was strong; to some members of the Committee, it appeared stronger than suggested by the staff projections.

The members agreed that growth in monetary aggregates recently had been at unacceptably high rates. . . .

It was observed that the moderate monetary policy that the System had been pursuing had contributed to a return of confidence; that to sustain confidence it was important for the System to demonstrate its intention to resist unduly rapid growth in the monetary aggregates; and that pursuit of that objective would run little or no risk of aborting the recovery in economic activity.

Meeting Held on June 22, 1976

Staff projections suggested that during the second half of the year real GNP would expand at a good pace and that prices would continue to rise somewhat faster than they had in the first quarter.

A staff analysis of the economic situation indicated that the economic expansion had slowed somewhat more in the second quarter than had been anticipated a month earlier. . . .

Immediately following the May meeting, the System had become a little less accommodative in the provision of reserves, as it aimed at reserve conditions consistent with a Federal funds rate averaging around 5⅜ per cent.

Data becoming available in the latter part of May suggested that the May-June rates of growth in both M1 and M2 would be near the upper ends of the Committee's ranges of tolerance. Accordingly, the System sought reserve conditions consistent with a Federal funds rate of about 5½ per cent.

. . .the Committee took note of a staff analysis suggesting that. . . growth in M1 would be influenced by increasing demands for money associated with expansion in nominal GNP, but that the rise in June was likely to be somewhat smaller than in July because of continuing adjustments of cash balances built up during the April bulge in money growth.

During the Committee's policy discussion, it was observed that the apparent moderation in the rate of growth in real GNP in the second quarter was, by and large, a healthy development, in the sense that continuation of the rapid first-quarter rate of expansion would soon have generated undesirable boom conditions. On the whole, the members were of the view that the economic expansion was proceeding satisfactorily and that the outlook was favorable. At the same time, some concern was expressed about the possibility that inflationary pressures would strengthen as the expansion proceeded.

The Committee agreed that it would be desirable to maintain relative stability in money market conditions at this juncture, in light of the current slowing of the economic expansion and the moderation of growth in the monetary aggregates since April.

A substantial majority favored a relatively narrow range of 5¼ to 5¾ per cent, on the grounds that a significant easing of money market conditions would be undesirable at this time in view of the likelihood that it might have to be reversed shortly, and that a significant firming would be inappropriate in view of the element of uncertainty in the economic outlook.

As at other recent meetings, they decided that approximately equal weight should be given to M1 and M2 in assessing the behavior of the aggregates.

Meeting Held on July 19-20, 1976

Staff projections continued to suggest that during the second half of the year real GNP would expand at a moderately rapid pace and that prices would rise somewhat faster than they had during the first half. Moreover, prospects appeared favorable for continuation of a good rate of expansion in real output into 1977.

. . .in early July, data becoming available suggested that in the June-July period growth in M1 would be below the lower end of the specified range while growth in M2 would be close to the lower limit of its range. In those circumstances, the System became a little more accommodative in the provision of reserves, and by midmonth the Federal funds rate had declined to around 5¼ per cent, the lower limit of the specified range.

During the Committee discussion at this meeting, some members stressed the signs of hesitation in the economic expansion in the second quarter. . . .

Several members expressed a belief that the pace of economic expansion would pick up again from the reduced rate in the second quarter, and a number anticipated that in the quarters immediately ahead growth in real GNP would be faster than that suggested by the staff projections.

In the discussion of current policy at this meeting, the Committee took note of a staff analysis suggesting that in the July-August period various factors that appeared to have depressed M1 balances in June would no longer be operating and, therefore, that M1 would expand appreciably.

As to policy for the period immediately ahead, members differed little in their preferences for ranges of growth in the monetary aggregates over the July-August period and for the midpoint of the inter-meeting range of tolerance for the Federal funds rate.

Differences of view were more marked with respect to the appropriate width of the range for the Federal funds rate. At its previous meeting, the Committee had agreed upon a relatively narrow range. . . .

Most members, however, favored specifying a somewhat wider range for the Federal funds rate . . . .Some of these members also stressed the existing uncertainty about the forces influencing the behavior of the monetary aggregates. . . .

. . .in their view this uncertainty was a reason for specifying a wider range for the Federal funds rate and for continuing to base operating decisions in the period immediately ahead primarily on the behavior of the aggregates.

It was agreed that until the next meeting the weekly-average Federal funds rate might be expected to vary in an orderly way within a range of 4¾ to 5¾ per cent.

Meeting Held on August 17, 1976

Staff projections continued to suggest that real GNP would expand at a moderate pace in the current quarter and that moderate growth in output would continue well into 1977. The projections also suggested that average prices in the current quarter and in subsequent quarters would rise somewhat faster than they had during the second quarter.

Staff projections for the second half of 1976 differed little from those of 4 weeks earlier; they continued to suggest that the slackening in economic growth in recent months would prove to be temporary.

As the inter-meeting period progressed, incoming data suggested that in the July-August period growth in M1 and M2 would be close to the midpoints of the ranges specified by the Committee. In these circumstances, System open market operations were directed toward maintaining conditions of reserve availability consistent with a Federal funds rate of about 5¼ per cent — the rate prevailing at the time of the July meeting and the midpoint of the operating range that the Committee had specified for the inter-meeting period.

In the discussion of current policy at this meeting, it was brought out that the accelerated expansion in M1 since early this year, taken in conjunction with the reduced rate of growth in nominal GNP and with relatively little change in interest rates, could indicate that the downward shift in the demand for money that was so evident in the latter part of 1975 was proceeding much more slowly.

During the Committee's discussion at this meeting no member expressed substantial disagreement with the staff projection of moderate growth in real GNP, although several members did stress the elements of weakness that had developed in the past few months. It was felt that uncertainty about the precise course of economic developments had increased. . . .

In general, Committee members felt that the pace of expansion in over-all economic activity would soon pick up again.

As to policy for the period immediately ahead, Committee members in general advocated continuation of the current stance. Most members favored directing operations toward maintaining about the current Federal funds rate. Accordingly, they preferred to give more weight than usual to money market conditions in formulating the operating instructions contained in the last paragraph of the domestic policy directive, and they advocated specifying a relatively narrow range for the Federal funds rate. . . .

It was agreed that System operations until the next meeting would be directed toward maintaining the weekly-average Federal funds rate at about its current level of 5¼ per cent. The members also agreed that, if growth in the aggregates should appear to be deviating significantly from the rates expected, the weekly-average Federal funds rate might be expected to vary in an orderly fashion within a range of 5 to 5½ per cent.

Meeting Held on September 21, 1976

Staff projections suggested that growth in real GNP would pick up somewhat in the fourth quarter and would remain at a good rate well into 1977. The projections also suggested that average prices would continue to rise at about the recent pace.

The rate of increase in M1 thus far in 1976 was consistent with the view that the downward shift in the demand for currency and demand deposits that was so evident in 1975 may have slowed. As a result, the velocity of M1 increased on the average over the second and third quarters of 1976 at a much slower rate than over the preceding three quarters. . . .

During the inter-meeting period the Federal funds rate deviated little from the 5¼ per cent midpoint of the operating range that had been specified by the Committee.

As to policy for the period immediately ahead, Committee members in general advocated continuation of the current stance. Interest rates, especially on long-term debt, had been adjusting downward, it was observed, in good measure because of improving confidence that the rate of inflation was being reduced, and also because of stability in the Federal funds rate.

There was near unanimity in the preferences expressed for ranges of growth in the monetary aggregates over the September-October period.

It was suggested that the relatively rapid growth in M2 ought to be accommodated.

With respect to the Federal funds rate, the members agreed that it would be appropriate to maintain the prevailing level of 5¼ per cent so long as the monetary aggregates were growing at about the rates expected. They differed, however, in their preferences for the width of the range for the funds rate.

It was observed, that if the Committee specified a wider range for the Federal funds rate than it had at the August meeting, it would be appropriate to place greater emphasis than at that meeting on the behavior of the aggregates in formulating the operating instructions contained in the last paragraph of the domestic policy directive issued to the Federal Reserve Bank of New York.

Meeting Held on October 19, 1976

Staff projections continued to suggest that growth in real GNP would pick up somewhat in the fourth quarter and would be sustained at about the fourth-quarter rate well into 1977. However, the projected rates of growth were slightly below those of a month earlier. . . .

Data that became available at the end of September indicated a substantial weakening in the growth of demand deposits. It appeared that in the September-October period growth in M1 would be below the lower end of the specified range while growth in M2 would be close to the midpoint of its range. In those circumstances the System began to be a little more accommodative in the provision of reserves, and the Federal funds rate eased to about 5 per cent.

During the Committee's discussion of the economic situation, several members expressed the view that the economic outlook was less favorable now than it had been a month or two ago, and that the risk of a shortfall from expected growth rates in real GNP had increased.

In the course of the discussion, it was pointed out that uncertainty about the fiscal policy that would be pursued in the months ahead — and about projections of economic activity for coming quarters — was greater than usual.

With respect to annual rates of growth in the aggregates over the October-November period, most members favored a range of 5 to 9 per cent for M1, given the rebound in growth already in train for October. For M2, most members favored a range of 9 to 13 per cent. While it was noted that these ranges were high in relation to the Committee's 12-month ranges for growth in these aggregates, it was argued that the Committee should consider that M1 had not grown at all in September and that recent and prospective rates of growth in M2 — and in M3 as well — reflected the temporary stimulus provided by recent declines in yields on market securities to levels below the rates being offered on deposits.

With respect to money market conditions in the period until the next meeting, most members favored a slight easing.

It was agreed that until the next meeting the weekly-average Federal funds rate might be expected to vary in an orderly way within a range of 4½ to 5¼ per cent. It was also agreed that the Manager should aim to reduce the Federal funds rate to about 4⅞ per cent within the next week, and to decide on subsequent objectives on the basis of incoming data on the monetary aggregates.

Meeting Held on November 16, 1976

The information reviewed at this meeting suggested that real output of goods and services . . . might be expanding at a somewhat slower pace in the current quarter. The rise in average prices . . . appeared to be somewhat faster than in the third quarter. . . .

Staff projections suggested . . . that growth in real GNP would pick up somewhat in the first quarter of 1977 and that it would be sustained at about the first-quarter rate well into the new year.

On October 21, 2 days after the October meeting, incoming data suggested that over the October-November period rates of growth in both M1 and M2 would be at about the upper limits of the ranges specified by the Committee. Therefore, it appeared likely that any reduction in the Federal funds rate in that week — pursuant to the Committee's consensus at the October meeting — would have to be quickly reversed. In those circumstances the Committee concurred in Chairman Burns' recommendation of October 21 that the Manager be instructed to continue to aim during that week for a Federal funds rate at about the prevailing level of 5 per cent.

Data becoming available during the following week continued to suggest unexpected strength in growth of the monetary aggregates. In response to an inquiry from the Manager concerning the appropriate interpretation of the Committee's instructions, Chairman Burns . . . . advised that in his judgment any significant increase in the Federal funds rate at that time from the prevailing level of 5 per cent would be inconsistent with the Committee's intent. No member of the Committee expressed the view that a rise in the Federal funds rate would be appropriate.

In their discussion of the economic situation, members of the Committee were in agreement that the sluggishness or "pause" in the growth of real output was continuing. As at the mid-October meeting, no member suggested that a recession was likely.

In the discussion of current policy at this meeting, members of the Committee in general favored some easing in money market conditions in the period immediately ahead, so long as growth in the monetary aggregates did not appear to be unduly rapid.

It was agreed that until the next meeting the weekly-average Federal funds rate might be expected to vary in an orderly way within a range of 4½ to 5¼ per cent. It was also agreed that the Manager should aim to reduce the Federal funds rate to about 4⅞ per cent within the next week and to about 4¾ per cent within the following week — provided that growth in the monetary aggregates did not appear to be strong relative to the specified ranges — and to decide on subsequent objectives on the basis of incoming data for the monetary aggregates.

Meeting Held on December 20-21, 1976

The information reviewed at this meeting suggested that growth in real output of goods and services in the fourth quarter had remained close to the pace in the third quarter. . . .

Projections of economic activity for the rest of 1977, it was noted, depended on the assumptions made with respect to the economic policies that would be pursued by the new administration taking office on January 20.

After the first week of December, incoming data suggested that in the November-December period growth in M1 would be below its specified range while growth in M2 would be at about the midpoint of its range. Therefore, System operations became somewhat more accommodative in the provision of reserves, and at the time of this meeting the Federal funds rate was about 4⅝ per cent — near the lower limit of the specified range. . . .

In their discussion of economic developments and prospects at this meeting, Committee members generally agreed that the latest business statistics indicated a strengthening in the situation and that the recent sluggishness appeared to have been only a "pause" in the growth of real output rather than the forerunner of a new recession.

Moreover, it was suggested that confidence had improved. . . .

Although Committee members in general viewed the business situation and outlook as having improved, some noted that the strengthening thus far had not been great and that it was not certain that the pause had ended.

Inflation also continued to be a source of concern . . . .

Some concern was expressed that fiscal stimulus might foster new inflationary expectations or that, as at times in the past, its effects might come so late in the expansion as to cause growth of real output to accelerate at a time when it should be moving gradually toward the longer-term rate of growth in potential output. The view was also expressed, however, that a degree of fiscal stimulus was desirable.

Most members favored giving greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting, in part because projections of growth in monetary aggregates around the year-end were highly uncertain. A majority favored directing operations toward maintaining the Federal funds rate at about its prevailing level of 4⅝ per cent for the time being, unless growth in the monetary aggregates appeared to be deviating significantly from the rates currently expected.

The members agreed that, if growth in the aggregates should appear to be strong or weak relative to the specified ranges, the weekly-average Federal funds rate might be expected to vary in an orderly fashion within a range of 4¼ to 5 per cent. As at other recent meetings, the Committee decided that approximately equal weight should be given to M1 and M2 in assessing the behavior of the aggregates.

Free Trade: A Major Factor in U.S. Farm Income

CLIFTON B. LUTTRELL

EXPORTS of U.S. farm commodities totaled $23 billion in 1976 and are expected to exceed that amount this year. Exports in the past year accounted for almost 25 percent of the dollar value of all farm commodity sales, and the 100 million acres of land utilized in producing this volume of exports represented 30 percent of the total acreage harvested. Thus, exports play a significant role in determining the nation's farm income.

Since 1970 farm exports have increased both in dollar value and as a share of total farm commodity sales. The 1975-76 marketing year was the seventh successive year of record agricultural exports in nominal terms. The $23 billion of farm products exported last year was almost four times the dollar value of farm exports in 1969 and more than double the value of 1972. The nominal value of farm exports rose at a 21 percent annual rate during the seven-year period since 1969, while in real terms (at constant prices) they rose at a 12 percent rate. The value of such exports rose from 14 percent of farm commodity sales in 1970 to 24 percent in 1976. Furthermore, in 1976 a smaller proportion of the exports was sold on concessional terms (aided by Government subsidies). Concessional sales abroad declined from two percent of total farm commodity sales in 1972 to one percent in 1976.

Farm exports as a percent of farm commodity sales have moved in a U-shaped pattern since World War I (see accompanying chart). In the early 1920s such exports exceeded 20 percent of gross farm receipts. By the late 1920s farm exports had declined to 17 percent of sales; they averaged 11 percent of sales during the 1930s, 10 percent in the 1940s, and 12 percent in the 1950s. In the 1960s exports rose to 15 percent of sales and continued upward in the 1970s, averaging 24 percent of sales in the three calendar years 1974-76 inclusive — almost the same as in the early 1920s.

RESTRICTIVE WORLD TRADE PRACTICES

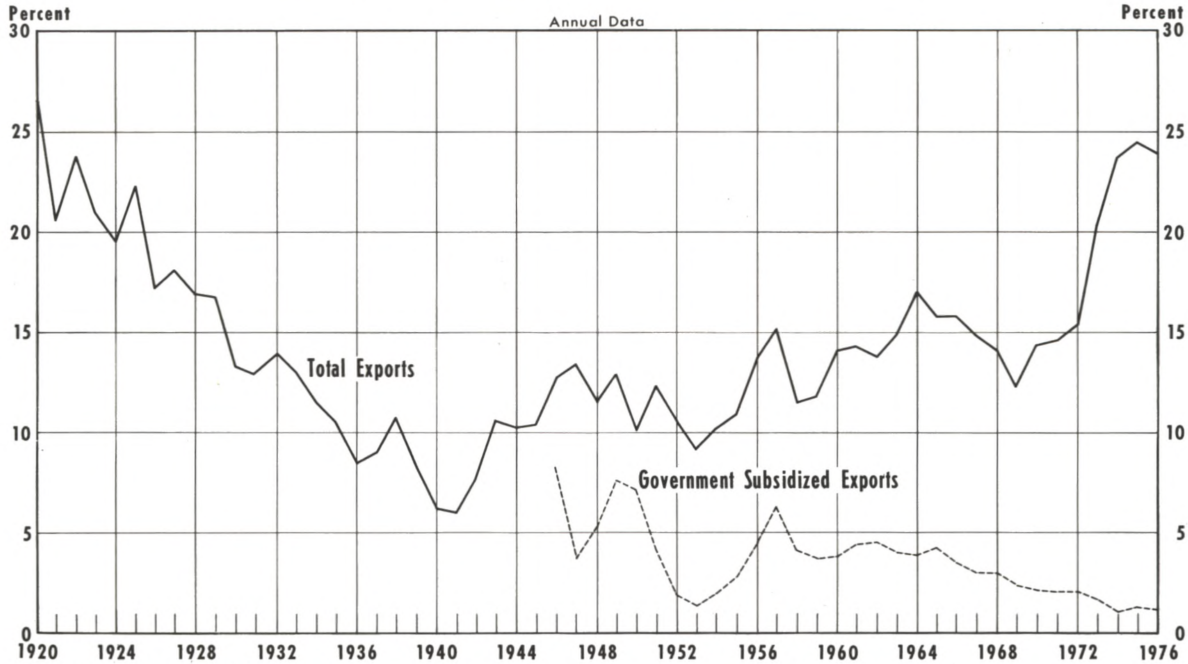
The downturn in farm exports in the 1920s can be largely traced to substantial increases in artificial restrictions on world trade in general. The relatively free trade era beginning in the mid-1800s — trade without high tariffs, quotas, and other government restrictions — was generally on the wane following World War I. In the 1920s there was an observable worldwide trend toward increased international trade restrictions. Britain, a traditionally free trade nation, levied the Key industries Duty in 1921 which imposed a 33.33 percent *ad valorem* tariff rate on many items. In addition, wartime duties were reimposed on a number of "luxuries" in 1925, after their lapse in 1924. The United States enacted the Fordney-McCumber Tariff in 1924 raising import duties on numerous items. Still higher duties were levied by the United States in 1930 with the passing of the Hawley-Smoot Act. This Act authorized tariff rate increases on more than 800 items during the early stages of the great depression. Other nations immediately retaliated by increasing their import duties.[1] Within two years general tariff increases were enacted in nine nations which comprised the major world market for U.S. farm products, including Canada, Cuba, Mexico, France, Italy, Spain, India, Argentina, and Brazil.

As a consequence of these trade restrictions and a worldwide depression, which began in 1929, world trade both in nominal terms and relative to GNP declined sharply. From 1929 to 1932, the dollar value of world trade dropped 61 percent, and the value of U.S. foreign trade fell 69 percent.[2] Total U.S. exports

[1]For a more comprehensive discussion of the impact of the Hawley-Smoot Act, sse Allan H. Meltzer, "Monetary and Other Explanations of the Start of the Great Depression," *Journal of Monetary Economics* (November 1976), pp. 459-461.

[2]*Statistical Yearbook of the League of Nations*, 1934-35.

Farm Exports As Percent of Farm Commodity Sales



Source: U.S. Department of Agriculture

declined from 4.9 percent to 2.7 percent of GNP during the period. Farm commodity exports declined from \$1.8 billion to \$0.75 billion during the three fiscal years ending in 1932. Farm exports as a share of total farm production, however, remained relatively stable during the early depression years despite the higher tariff rates. In 1930, the first full year of the depression, farm exports amounted to 13 percent of farm commodity sales, and at the trough of the depression in 1933 such exports, while declining sharply in nominal value, still totaled about 13 percent of sales.

Free International Trade Espoused . . .

With a new Administration in 1933, the political climate changed, and this nation began to espouse the cause of free international trade. The Hull Reciprocal Trade Agreements Act was passed in 1934, the first of a series of legislative attempts to expand international trade. Other tariff reduction acts and international agreements further contributed to free trade practices. Especially significant were the General Agreement on Tariffs and Trade in 1947 and the Trade Expansion Act of 1962 which authorized the President to negotiate numerous tariff reductions.

While attempts were being made to expand international trade through tariff reductions, Congress enacted special legislation in a number of instances which was designed to expand farm exports through the use of export subsidies. The expansion of farm exports through the use of Government subsidies was a major factor in the post World War II assistance to Europe and Japan under the United Nations Relief and Rehabilitation Administration, the Marshall Plan, and other relief and recovery programs. A fixed portion of the foreign economic aid funds in 1954 was earmarked to buy surplus farm commodities from the United States. Public Law 480, passed in 1954, was specifically designed to provide a foreign outlet for "surplus" farm products. While these programs were not restrictive within themselves, they tended to produce retaliatory restrictive actions by other nations.

. . . But Restrictive Farm Programs Enacted

Despite the stated free trade objectives in the foreign trade legislation and international agreements of the 1930s and the following decades, the major farm programs enacted during this period tended to restrict farm product exports. In 1943 Professor Theodore W. Schultz, in a study of domestic farm programs, pointed out that most of the agricultural agencies established during the 1930s were designed to do one thing — provide "parity" (higher than free-market) prices for farm products.[3] The methods used to attain this objective were supply and production controls, price supports, commodity storage, and surplus disposal programs.

Production Controls and Price Supports

In 1933, when the New Deal came into being direct legislative action was taken to increase farm product prices to levels above those dictated by the free market. The Agricultural Adjustment Administration was established to curtail production of most major crops. A specific number of acres was allocated to the key crops on each farm. Price supports were set through Commodity Credit Corporation (CCC) nonrecourse loans to farmers on stored commodities. The loan and storage programs, financed at taxpayer expense, were designed to guarantee a specific price, usually above the free market level, to farm producers by restricting the flow of commodities to both domestic and export markets. The surplus disposal programs — Public Law 480, school lunches, food stamps, and other food disposal schemes — were all designed to increase total demand for farm products and thereby enhance prices. The Public Law 480 program, which subsidized exports of farm commodities to the less developed nations, may have increased farm exports somewhat. However, such programs were disruptive of normal trade flows, and generally have been regarded as "dumping" when used by other nations to export products to the United States.

Production controls and price supports have been a major deterrent to the expansion of international trade in farm products over most of the period since the early 1930s. They reduced domestic farm output and led to increased prices for farm products to all users, both domestic and foreign. The average price of U.S. farm products rose at the rate of 15 percent per year from 1932, the last year prior to the programs, to 1935. In comparison, the average price of industrial commodities rose at a 3.4 percent rate during this period.

Following the production controls and price supports, U.S. farm commodity exports declined both relative to farm commodity sales and as a share of total U.S. exports. Farm exports, which accounted for 14 percent of farm commodity sales in 1932, dropped to 11 percent of such sales in 1934 following the restrictions, and continued downward to 8.5 percent in 1936 (see chart). Farm exports averaged 38 percent of total U.S. exports during the eight years prior to the programs (1926-33). Farm exports declined to an average of 29 percent of total exports from 1934 to 1940 and to 23 percent of total exports from the end of World War II until 1971, despite the government subsidies on a sizable portion of the farm commodities exported.[4]

The artificially high farm product prices resulting from the production controls and price supports caused the rest of the world to increase the production of farm products from the amounts that would have otherwise been produced. The higher farm product prices increased the returns to resources in agriculture and caused increased resources to move into the industry in the rest of the world. Consequently, farm production outside the United States was enhanced and U.S. farm exports reduced. In addition, increased resources moved into the production of farm commodity substitutes both here and abroad leading to a further reduction in world demand for U.S. farm products.

Cotton

One prime example of the consequences of the U.S. farm production controls and subsidies was the sharp decline in the usage of domestic cotton. In 1930, prior to the acreage controls and price supports, this nation supplied more than 50 percent of the world's cotton production. At the beginning of World War II, after seven years of the programs, cotton production in the United States had declined to 40 percent of the world total, and the nation's share continued down to less than 20 percent of the world total in 1970. In 1930 the United States exported 7.1 million bales of cotton, or more than 50 percent of total world cotton exports. By 1940 U.S. cotton exports had declined to 1.2 million bales or about 15 percent of the world total. The volume of domestic cotton exports rose following World War II, but in 1970 U.S. exports totaled only 3.7 million bales, or 22 percent of the world total.

The cotton programs had a major impact on world land resource use as indicated by shifts in the acreage used for cotton production. During the 1930s cotton harvested in the United States declined 43 percent, from 42 million to 24 million acres. In contrast, cotton harvested in foreign countries rose 24 percent, from 43 million to 53 million acres during the period. In the 40 years from 1930 to 1970, during most of which pro-

[3]Theodore W. Schultz, *Redirecting Farm Policy* (New York: The Macmillan Company, 1943), p. 6.

[4]U.S. Department of Agriculture, *Agricultural Statistics, 1972*, p. 698.

duction controls and price supports were in effect, acres of cotton harvested in the United States fell 74 percent, whereas the acreage harvested in the rest of the world rose 57 percent. Although part of the reduction in cotton acreage in the United States reflected rising domestic yields and technological developments in the synthetic fiber industry, a large part of the shift can be attributed to the restrictive cotton programs.

While the impact of the cotton restrictions on the use of synthetic fiber substitutes is difficult to assess, the higher prices for cotton resulting from the restrictions were no doubt a factor contributing to the sharp increase in synthetic fiber usage. At the beginning of the controls in 1933, synthetic fiber substitutes were virtually unknown. Following World War II such fibers began to compete aggressively with cotton, and by 1975 the poundage of such fibers used by domestic mills was more than double that of cotton.

Wheat

Cotton is only one example of export markets being undermined by domestic farm production restrictions and price supports. The wheat acreage controls and price supports had a similar impact. The Government began to hold wheat off the market in mid-1929 through loans to farmers by the Federal Farm Board. In 1933 domestic acreage controls and the International Wheat Agreement further contributed to rising wheat prices and a reduction in wheat exports. While the downward adjustment in domestic wheat acreage was not as much as was planned during the early years of the controls, because of the drought in 1933 and 1934, the controls did reduce production, and wheat prices rose.[5] The prices received by farmers rose from an average of $0.48 per bushel during the three years 1930-32 to $0.82 during the six years 1934-39. Exports declined from an average of 103 million bushels per year during 1930-32 to an average of 56 million bushels per year during 1934-39.

The adjustments in resource use in some of the major wheat importing nations as a result of the higher prices took a predictable route. The largest wheat importer, the United Kingdom, increased its wheat acreage by plowing up some grassland and planting it to wheat. Italy expanded her acreage by clearing and draining the Pontine Marshes. France made more extensive use of her North African possessions for wheat growing, thereby reducing both domestic wheat production and imports from the United States.

In the United Kingdom wheat prices in 1933 had declined to 67 percent of the 1930 level; they declined further in 1934 but rose sharply in the next three years and during the two years 1937-38 they averaged 51 percent above the 1933 level. The cereal portion of the food price index likewise rose sharply, increasing by 42 percent from 1933 to the average for 1937-38. In contrast to the sharp increase in cereal prices, the meat-fish and other food sectors of the consumer price index rose only 12 and 13 percent, respectively. In response to these changing price relationships British farmers found it profitable to plow up grazing land on which meat was being produced and seed it to wheat. The acreage seeded to wheat rose from 1.34 million in 1932 to 1.92 million in 1938, an increase of 43 percent. Wheat production in the nation rose 67 percent during the period, and imports of wheat declined. Total wheat and flour imports by the United Kingdom declined 12 percent from the 1931-33 average to the 1937-38 average.[6]

Exports of most other major crops, including feed grains, tobacco, rice and peanuts have likewise been affected by the farm programs, but not to the same extent as wheat and cotton.

The unfavorable impact of the farm price supports and controls on exports was pointed out by Professor Dale Hathaway in 1963:

> Suddenly in the mid-1950's the impact of our domestic programs upon foreign trade in farm products came home to roost with a vengeance. Exports of farm products fell precipitously, aggravating the domestic stocks problem and threatening us with a permanent loss of foreign markets as foreign supplies expanded to fill the gap.[7]

Controls Relaxed and Exports Rose

In recent years Government controls on agriculture have been relaxed, and greater reliance has been placed on free market forces in the use of farm production resources and the pricing of farm commodities. Since the enactment of the Agricultural Act of 1970, most of the domestic farm restrictions have been

[5]In 1934 Sherman Johnson estimated that the wheat programs had resulted in prices 10 to 15 cents per bushel higher than they otherwise would have been. See *Wheat Under the Agricultural Adjustment Act* (The Brookings Institution, 1934), p. 90.

[6]B. R. Mitchell, *Abstract of British Historical Statistics* (Cambridge: Cambridge University Press, 1962), p. 99.

[7]Dale E. Hathaway, "Evaluation of Agricultural Programs in Terms of Economic Growth, Foreign Trade, and Political Feasibility: A General Appraisal," *Increasing Understanding of Public Programs and Policy* (Chicago: Farm Foundation, 1969), p. 73.

redesigned to permit competitive pricing of most crops including wheat, feed grains, the major oilseeds, and cotton. Acreage controls for most crops were largely removed in 1974 with the elimination of the set-aside provisions for cotton, wheat, and feed grains. This action freed about 60 million additional acres for crop production. CCC loans on basic crops have been continued, but the rates have generally been set below world-price levels and subsidies on the production of many farm commodities have been eliminated.

The decline in the impact of the Government price-support programs on the price of farm commodities is indicated by the reduced volume of CCC loans and holdings. In 1965 the value of farm commodities owned by the CCC totaled $4.1 billion and the corporation had an additional $2.6 billion of loans outstanding on farm commodities through price support operations. By 1974 the value of commodities owned by the CCC had declined to $188 million, and CCC loans outstanding were down to $681 million. The freeing of agriculture from excessive production restrictions and the return to the price mechanism as the major instrument in managing the farm economy has no doubt been a major factor in the sharp increase in farm exports in recent years.

Table I

GROSS NATIONAL PRODUCT AND EXPORT GROWTH IN LARGE COMMERCIAL NATIONS

(Compounded Annual Rates of Change)

	1960-64	1970-74
Canada GNP	7.0%	13.2%
Exports	5.9	24.4
France GNP	10.1	13.1
Exports	13.4	29.2
Germany GNP	8.7	9.7
Exports	9.5	24.7
Italy GNP	11.9	13.9
Exports	10.5	28.1
Japan GNP	16.0	17.0
Exports	15.0	36.5
Netherlands GNP	10.3	12.9
Exports	11.7	26.5
United Kingdom GNP	6.5	12.5
Exports	3.8	26.9
United States GNP	5.9	9.2
Exports	5.4	25.9

Source: United Nations, *Monthly Bulletin of Statistics* (August 1976), pp. 186-189, (May 1968), pp. 176-179, and International Monetary Fund, *Direction of Trade 1966-70*, p. 2, and *Direction of Trade 1960-64*, p. 2.

Other Factors Contributed to Rising Farm Exports

A rising volume of world trade in recent years has contributed to the sharp increase in U.S. farm exports. Since 1970 exports of the eight major commercial nations listed in Table I have increased faster than their Gross National Product (GNP), and in most cases export growth has more than doubled the rate of GNP growth. In contrast, from 1960 to 1964 exports rose at about the same rate as GNP.

In addition to the relaxation of farm programs which has contributed to rising world trade in recent years, other factors affecting the rising volume of farm exports include: a relatively peaceful international situation, the move to more flexible exchange rates, some further tariff reductions, the OPEC oil cartel, and rising real incomes. For centuries the threat of war and the alleged demands for national defense have been used as arguments for greater self sufficiency. The military strength of a nation is believed by many people to be enhanced by self-sufficiency in economic production, particularly food. Consequently, during periods of major threats to world peace and immediately after major international disturbances the proponents of self sufficiency are likely to influence national trading policy, especially in those nations which import a large percent of their food supply. These proponents of self sufficiency hold that it is safer in an uncertain world to provide the basic necessities at home even at higher costs.[8]

The move to more flexible exchange rates in 1971 probably contributed to the rise in total international trade by the United States and, thereby, to an increase in farm exports. During the late 1960s the dollar was overvalued in international trade — that is, at the fixed exchange rate American produced goods were less attractive in the international market than foreign produced goods. Consequently, foreign purchases of goods and services from the United States declined relative to foreign sales to the United States. However, with the establishment of the floating exchange rates which emerged from the so-called crisis of 1971, the dollar was no longer overvalued relative to other currencies and, as a result, U.S. exports of goods and services rose.

While it is argued by some that flexible exchange rates increase the risks of international trade, others point out that the market pricing of currencies leads to a reduction in trade restrictions. Governments often attempt to maintain their currency values by limiting imports and thereby limiting the amount of domestic currency flowing into international exchange markets. Such restrictions reduce the volume of trade

[8]Charles P. Kindelberger, *Foreign Trade and the National Economy* (New Haven: Yale University Press, 1962), p. 142.

and the consumption and investment opportunities of the people. Nevertheless, the tendency to restrict trade for purposes of maintaining artificial exchange rates is well entrenched in the political arena.[9] With the demise of fixed rates this reason for erecting trade barriers no longer exists.

Negotiations by the General Agreement on Tariffs and Trade (GATT) members toward further tariff reductions have continued in recent years. In 1973 the members adopted a new Multifiber Textile Agreement which is expected to liberalize and expand world textile trade. The Trade Act of 1974 further expanded the President's negotiating authority to reduce tariffs. Also the nation's economy is probably still adjusting to reduced tariff barriers negotiated following the Kennedy round of tariff reductions in the 1960s. On the other hand, an increasing amount of the trade negotiations in recent years appears to have been negative. The agreements contain numerous safeguards and relief provisions for real or imagined damage to specific industries or labor, and safeguards to national security. Such actions, taken to reverse earlier free trade practices, tend to offset actions intended to further liberalize trade.

While the higher oil prices following the actions of the OPEC cartel cut two ways in the export picture, they probably contributed to increased U.S. farm exports on balance. U.S. oil purchases from abroad have increased several fold since the cartel was formed, and a larger quantity of farm commodities are required to purchase a given quantity of oil. On the negative side, however, a number of the major importers of U.S. farm commodities, such as Japan and Germany, now use a larger portion of their foreign exchange to purchase oil from the OPEC nations. Apparently these nations will have less foreign exchange to purchase farm products from the United States.

Free Trade — A Boon to American Agriculture

The sharp increase in U.S. exports within the free market setting of recent years reflects a further concentration of resources in those sectors of the nation's economy having the greatest relative advantage. World trade rises as a result of further specialization in resource use. Each trading nation specializes in the production of those commodities in which it has a relative advantage over the rest of the world. Nations tend to make resource adjustments more nearly in accord with production efficiencies and world markets. World resources move to those uses which will provide maximum returns. Consequently, each nation produces those products in which it has the greatest relative advantage.

The United States has a relative advantage in the production of agricultural commodities. This nation has an abundance of fertile soil, generally favorable weather, and relatively high technological development in agriculture. Consequently, by specializing in agricultural production and trading farm products for the products of other nations, such as petroleum, metals, tropical fruits, coffee, and other imports, we have more goods available for consumption than would be available without the specialization of production and trading. Our increase in farm exports is thus more than matched by a gain in our ability to purchase goods and services produced by other nations. Conversely, the gain in exports to the United States by other nations increases their ability to purchase our farm products and provides them with more goods for consumption. Consequently, any restrictions which dampen our imports or interfere with international trade in any way reduce the degree of mutually profitable international specialization and thereby restrict the export market for domestic farm products.

External world trade and U.S. farm exports can be expected to increase further as the major economies of the world accept freer trade policies. For trade to continue to expand, however, free trade policies are necessary for both exports and imports. Restrictions on imports of foreign goods and services, farm price supports and production controls, and quotas on exports are not conducive to world trade growth. Nations which follow such arbitrary trade restricting practices and production controls cause importing nations to lose confidence in them as a source of supply. Importers will thus become more self sufficient or look elsewhere for a more reliable supply for the same reason that the United States hopes to gain greater self sufficiency in petroleum production and usage. If the United States can avoid such restrictions, our farm exports should continue to expand. Farmers will experience gains from the expansion. Imports of nonfarm products should increase and somewhat slower growth will occur in the domestic production of those types of products that are imported. However, greater expansion will occur in the farm sector and in the farm supply industries such as fertilizer and farm machinery. Hence, the rise in specialization

[9]See Gerald M. Meier, *Problems of Trade Policy* (Oxford University Press, 1973), p. 16.

and foreign trade will not cause any net loss of jobs or reduce the overall returns to labor and other resources. In contrast, all trading nations should gain from the greater output and consumption resulting from further world specialization of resource use and production.

CONCLUSION

Since 1970 U.S. farm exports have risen sharply, both in dollar value and relative to total farm commodity sales. Farm exports now account for almost 25 percent of the value of all farm commodity sales, about the same percent as in the early 1920s — a period of relatively free trade.

During the four decades from 1933 to 1972, farm exports averaged less than 12 percent of farm commodity sales. During most of this period, farm product prices were maintained above free market levels through Government production control and price support programs. These programs limited the expansion of farm exports by raising the costs of such commodities to foreign purchasers. At the higher prices, foreign producers had greater incentive to increase production of these and substitute products. In addition, the support prices contributed to the replacement of cotton by synthetic fibers in both domestic and foreign markets.

With the elimination of most price supports and production controls on farm products in the early 1970s, farm exports relative to total sales again climbed to about their 1920-30 levels. While a portion of the recent farm export gains can be attributed to reduced tariffs and other factors, such as the move to more flexible exchange rates and a relatively peaceful international scene, part of the gain is attributable to the relaxed domestic price support and production control programs.

If the restrictive farm programs are not reimposed, and free trade practices are maintained, a high percentage of the nation's farm production will probably continue to be exported. This nation has a relative advantage in the production of most farm products and under a free trade regime farm exports will rise. A rising volume of farm exports under free market conditions is beneficial to American farmers and at the same time increases the goods and services available to all people in the trading nations.