June 16, 1981

To: Board of Governors
Reserve Bank Presidents

From: Don Winn

The Senate Banking Committee has finally issued its Monetary Policy Report to the Senate resulting from the Federal Reserve's February Humphrey-Hawkins Report to the Congress.

The Committee Report finds the FOMC target ranges to be appropriate, states that the growth rates should be at or around the midpoint of the target ranges, and says that deviations as large and prolonged as those of 1980 should not be allowed in the future.

More specifically, the Committee Report sets forth the following views and recommendations:

-- Concurs with the Federal Reserve that "a reduced rate of inflation is the key to sustainable economic growth, full employment and an increased savings rate."

-- "The degree of monetary restraint implied by the FOMC's target ranges for growth in the monetary and credit aggregates during 1981 appears appropriate at this time and appears compatible with the Administration's other policies for combatting inflation . . ."

-- "Questions whether the Federal Reserve's credibility will not be damaged . . . by the promulgation of a 3.5 to 6.0 percent target range for M-1B expansion when M-1B actually is expected to increase by 6.0 to 8.5 percent as a result of shifts into ATS and NOW accounts from savings accounts."

-- "Believes that the credibility of monetary policy requires that significant deviations, such as occurred in 1980, should not be allowed between the aggregates realized growth rates for a year and the approximate midpoints of the announced target ranges."

-- "Underscores Dr. Weidenbaum's finding that . . . compatibility between monetary policy and the other elements of the Administration's overall economic strategy will necessitate that 1981 growth in the aggregates be 'at or around the midpoint of the target ranges'."

-- "The uncertainty over just how long deviations from targeted growth can continue before doing economic damage, together with the threat to the credibility of monetary policy arising from deviations as large and prolonged as those of 1980 require that such fluctuations not be allowed in the future."

-- "The highly destructive impact on both the monetary aggregates and on real output which arose from the application of credit controls during the second quarter of 1980 gives strong cause for resisting such controls in the future."

-- "Chairman Volcker and the other members of the Board of Governors should be applauded for their continuing evaluation of alternative techniques for implementing policy designed to improve short-run monetary control as recommended by Chairman Garn and Senator Proxmire."

-- "Attainment of full employment and balanced growth will require that an anti-inflationary monetary policy be accompanied by federal budget restraint, and the Committee recognizes the responsibility of Congress in exercising such budget restraint."

* * * * *

In a statement of "Additional Views," Senator Proxmire strongly disagrees with the Report's recommendation that short-run fluctuations in monetary growth "not be allowed in the future." Proxmire says:

"The Committee's admonition against short-run money supply fluctuations echoes the views of extreme monetarists such as Beryl Sprinkel, the Under-Secretary of the Treasury for Monetary Affairs. In testimony before the Joint Economic Committee, on April 8 Mr. Sprinkel recommended that the Federal Reserve completely ignore interest rates and focus exclusively on the adjusted monetary base or adjusted bank reserves. These extreme monetarist prescriptions would have a disastrous effect on our financial and economic system if they are taken seriously by the Federal Reserve. Uncontrolled fluctuations in short-term interest rates would place an intolerable burden on thrift institutions, small business firms, farmers, and others who could easily be forced into bankruptcy if they failed to anticipate an abrupt swing in short-term interest rates.

"I am concerned that the traditional independence of the Federal Reserve is being threatened by the constant stream of 'advice' emanating from the upper reaches of the Reagan Administration which presumes superior knowledge not only on the end objectives of monetary policy, but on the technical methods of implementation as well. I find it curious that those in the Congress who have been among the staunchest defenders of the independence of the Federal Reserve have become strangely silent over the latest assaults on the Fed's independence by members of the Reagan Administration.

. . . . .

"How far can we suppress short-term variations in money growth before setting off counter-productive fluctuations in short-term interest rates? This is largely a technical question that is best left to the expertise of the Federal Reserve. It should not be decided by the rigid application of monetarist ideology advanced by those who have no official responsibility for the conduct of monetary policy."

* * * * *

In another statement of "Additional Views," Senators Williams, Riegle and Sarbanes criticize the Committee's Report for its emphasis on keeping the growth of the monetary aggregates regularly at the midpoints of the announced target ranges. They charge that this may cause "even higher rates and more erratic savings in interest rates than we have experienced during the past eighteen months, and in so doing gives priority to theoretical as opposed to practical objectives."

Williams, Riegle and Sarbanes also express concern about unemployment. "We note with consternation and regret the failure of the Federal Reserve and the Committee to give any serious consideration to the problems of persistent unemployment and the relationship of monetary policy to employment levels."

Attached is a copy of the Committee's Report.

Attachment
cc: Messrs. Axilrod, Coyne, Ettin, Kichline, Mannion, Prell, Syron, and Truman