Federal Reserve Bank of Minneapolis

McGILL UNIVERSITY

Federal Reserve Bank of Minneapolis

1984 Annual Report

The Transition to Low Inflation: Progress and Pressures

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President's Message

Recent annual reports of this Bank have considered in some depth major issues related to banking and economic policy. The 1984 Annual Report continues this tradition with the essay "The Transition to Low Inflation: Progress and Pressures." A basic thrust of the essay is that the transition to low inflation has been difficult and costly for certain sectors and institutions—including some important to the Ninth Federal Reserve District—despite the healthy overall expansion of the economy during the past two years. In view of these problems, temporary assistance programs designed to aid specific industries with the adjustment to low inflation may be appropriate. But such programs are merely intended to smooth the transition process and are in no sense adequate substitutes for the responsible monetary and fiscal policies necessary for sustained prosperity with low inflation. Against the background of the considerable progress made to date, we have the opportunity, if we act wisely, to achieve this objective.

Gary H. Stern
President

The Transition to Low Inflation: Progress and Pressures

Overview

The United States seems to be in transition to a low inflation economy that has the potential for serving as the basis for broad and enduring prosperity. However, our present circumstances and prospects, although favorable in many respects, may be jeopardized in the long run by large federal budget deficits. These deficits are fundamentally incompatible with price stability over time and, moreover, add to the heavy costs already imposed on specific sectors and institutions by the transition to low inflation. These sectoral costs in turn are significant not only because of the immediate pain inflicted, but also because they may lead to ill-conceived countermeasures that could threaten progress in reducing inflation and, therefore, our establishment of durable prosperity.

Any effort to deal effectively with these transition costs and to smooth the route to permanently low inflation and sustained growth and prosperity, then, must include prompt and credible action to reduce federal budget deficits. Policies designed instead to assuage industries such as agriculture, mining or manufacturing, if not carefully targeted and administered, risk compromising the discipline essential to restoring price stability. Such policies may be appropriate, but caution must be exercised so that policies are selected that are consistent with long-run economic efficiency considerations.

In aiding troubled sectors, market incentives can probably be best maintained by relying as much as possible on the private sector. Debt relief programs, for example, should encourage case-by-case financial restructuring between borrowers and lenders. To the extent that introduction of public funding is appropriate, it should be targeted to debtors who demonstrate progress in restructuring their businesses and rehabilitating their finances. Moreover, such programs are intended to deal only with transitional problems and, as such, are premised on the expectation that the underlying problem — excessive federal budget deficits — will be addressed effectively.

This essay begins with a review of the macroeconomic policies pursued over the past several years and the performance of the economy in the wake of these policies. The focus then shifts to a discussion of sectoral difficulties encountered in the transition to low inflation, difficulties compounded by high real interest rates and federal budget deficits. The essay's final section proposes policies that seem to us necessary for continued progress toward price stability and economic growth.

Two-Pronged Policy Approach

A two-pronged approach to macroeconomic policy has evolved over roughly the past five years. In a sense, monetary policy has focused on reducing the rate of inflation, while fiscal policy has been primed to stimulate economic growth.

Against the background of the escalation of inflation in the 1978-81 period, Federal Reserve policy moved progressively to discipline the money creation process. After exceeding its target ranges in 1977, 1978, and 1979, growth in the basic money supply (M1) was brought within target in 1980 and was reduced further in 1981. Although growth of the money supply, M1 in particular, was erratic in these years—partly because of shifts in the demand for various assets as deregulation of the financial sector proceeded and as expectations about future inflation and economic performance changed—this overall slowing in money growth was critical to the subsequent reduction in inflation.

At the same time, fiscal policy was moving in the opposite direction. Substantial business and personal tax cuts were embodied in the Economic Recovery Tax Act of 1981, with the express objective of stimulating and fostering economic growth. Although subsequent budget actions (such as Tax Equity and Fiscal Responsibility Act of 1982) reduced the budget stimulus somewhat, the net effect was clearly expansionary. Unprecedented federal budget deficits accompanied the package, because the tax reductions were not matched by comparable restraint on federal spending. Given the Federal Reserve's anti-inflationary stance, these deficits were not financed to any meaningful extent by monetary policy. The resulting policy mix, then, was a highly expansionary fiscal policy accompanied by continued restraint on the monetary side.

Progress on Many Fronts

This policy mix has been accompanied by significant improvement in economic performance. Indeed, in broad terms, the record of the U.S.

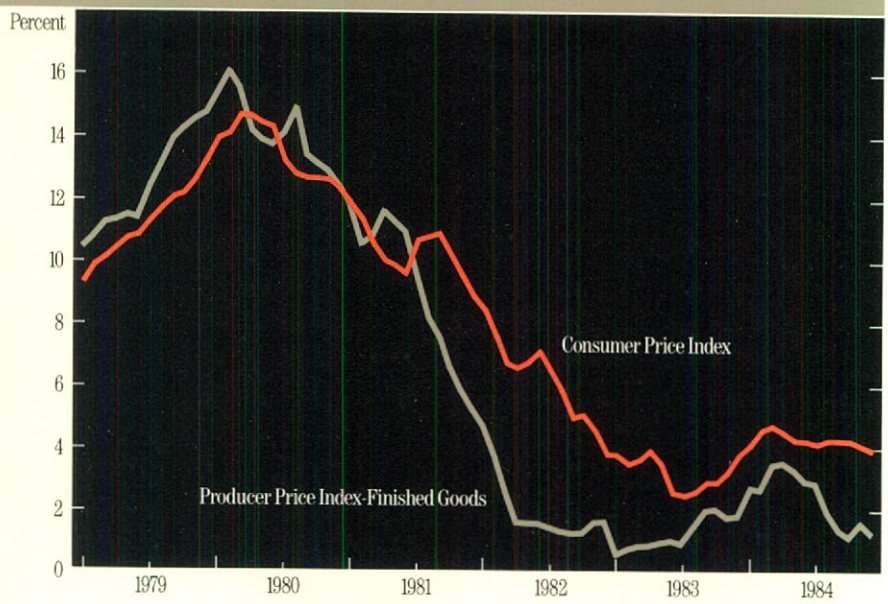
economy since the end of the 1981-82 recession has been exemplary. By several yardsticks, the expansion in economic activity has rivaled or surpassed previous postwar recoveries. And surprisingly, inflation has not moved up appreciably, as it has in most postwar recoveries. This performance, especially viewed against the backdrop of the subpar economic gains, high unemployment, and accelerating inflation of the 1970s, has raised hopes, and to some extent expectations, that basic structural improvement in the economy is under way that will provide the building blocks for sustained prosperity over time.

There are many positive aspects to the recovery to date. Over the past two years, for example, growth in real GNP has averaged 6 percent, the best performance since 1950-51, and the gain in industrial production has exceeded this pace. Real disposable income, aided in part by the personal tax cuts, has increased steadily throughout the expansion and, in addition, aggregate employment has risen by more than 7 million, testifying to the marked improvement in labor market conditions. Cyclically sensitive industries, like automobiles and housing, have exhibited renewed vigor. As to capital investment, the strength in outlays since the onset of the economic expansion has been considerable, ranking with the best in the postwar period. Indeed, real capital spending—as measured by nonresidential fixed investment—has increased at an annual rate of more than 15 percent since the fourth quarter of 1982. The increase has been rather broadly distributed, although the growth in spending on equipment began earlier and has been more robust than the pickup in spending for structures. Within the equipment category, the increase in outlays for electronic systems, including computers and other automation machinery, has been especially strong.

But these developments, welcome as they are, testify to only a part of what has been accomplished over the past several years. Along with marked improvement in economic activity has come significant progress in reducing inflation (see Chart 1) and inflation expectations in our economy. Sharp deceleration in price and wage pressures began in the 1981-82 recession, and moderation in inflation has been extended as the recovery has proceeded. This is without question a distinctly encouraging development. For our economy to work well over a prolonged period, reasonably stable prices are a prerequisite.

Although there remains a considerable distance to go, progress toward price stability has in several respects been remarkable. Despite the fact that the business expansion is roughly two years old, prices and wages are rising only slightly more rapidly now than they were at the bottom of the recession. There are several reasons for this performance, including ample supplies of energy, raw materials, and food. However, critical ingredients in recent price developments have been the international economic situation and the aforementioned discipline in monetary policy.

Chart 1 Changes in Prices, 1979-1984



Twelve month percent change

Source: U.S. Department of Labor, Bureau of Labor Statistics

Substantial competition from abroad has served to increase the availability of numerous products in this country and has acted to restrain inflationary pressures which might otherwise have built in the wage and price determination process. Essentially, as the United States has become more closely tied to the world economy, the productive capacity at our disposal has expanded, in this case making the economy more resistant to inflationary pressures. Some indication of this is provided by prices of raw materials and wholesale prices more generally. At the wholesale level, prices clearly have not increased as rapidly thus far in the expansion as is typical, based on comparisons with previous business cycles. Hence, a buildup in pressures early in the production or distribution process that ultimately may be translated into higher prices confronting consumers and other end users seems to be delayed and, perhaps, avoided altogether.

Moreover, the market discipline inherent in internationalization and growing worldwide economic interdependence has contributed to the moderation which has characterized major collective bargaining agreements—and wage increases more generally—over the past two years. Excluding potential gains under cost-of-living clauses, increases in major collective bargaining settlements in 1984 averaged 2.3 percent, the third consecutive year such agreements were less than 4 percent.

There are other indicators favorable to lasting moderation in wage and price pressures. Beyond developments at the wholesale level, it is clear

that unit labor costs are turning in a much more favorable performance than is normal in a recovery. Indeed, since the trough of the business recession, unit labor costs have increased only about 1.7 percent. Impressively, the recent performance of unit labor costs cannot be attributed to unusual increases in labor productivity. Productivity, in fact, has risen no more than average thus far in the business cycle. Rather, the relative stability in unit labor costs stems largely from moderation in wage and benefit increases, which have climbed at about a 4 percent annual pace since the recovery began. This moderation is atypical for business cycle expansions and is particularly heartening when compared to the large nominal increases in compensation that characterized much of the 1970s.

Transition to Low Inflation

With appropriately disciplined public policies, the recent progress in reducing inflation can be solidified and extended. The pattern of recent wage settlements, for example, suggests growing confidence in the probable success of policies designed to achieve low inflation. Because inflation has been lowered in a consistent and systematic way over the past several years, attitudes and expectations are now starting to work for us in restraining cost and price pressures.

Moderate increases in wages might well be accompanied by favorable developments in the second major component of labor costs—namely, productivity. Admittedly, the productivity outlook remains uncertain, in part because to this point in the cycle there is little if any evidence suggesting better than normal productivity gains. However, two identifiable factors may boost productivity: one is the aforementioned substantial increase in capital spending, particularly for technologically sophisticated equipment; the other is demographics.

With the maturing of the postwar baby generation, the labor market in this country may have cleared several critical hurdles. In the 1970s, the baby boom contributed to an enormous influx of new workers, an influx that at least in relative terms was inexperienced, loosely attached to the labor force, and to some extent unskilled. As these workers have gained skills and job attachment, their productivity has naturally increased. Moreover, since the baby boom was followed by a "baby bust," the economy does not face the prospect of absorbing a bulge of this type of labor in the 1980s. Hence, with the absorption substantially behind us, productivity may improve on a more consistent basis. Between 1953 and 1973, labor productivity increased 2.7 percent annually in this country. But between 1973 and 1982, this trend faltered, averaging less than 1 percent per year. While a return to the kind of increases experienced in the twenty years following 1953 may not occur,

some perceptible improvement in productivity does not seem unreasonable at this point.

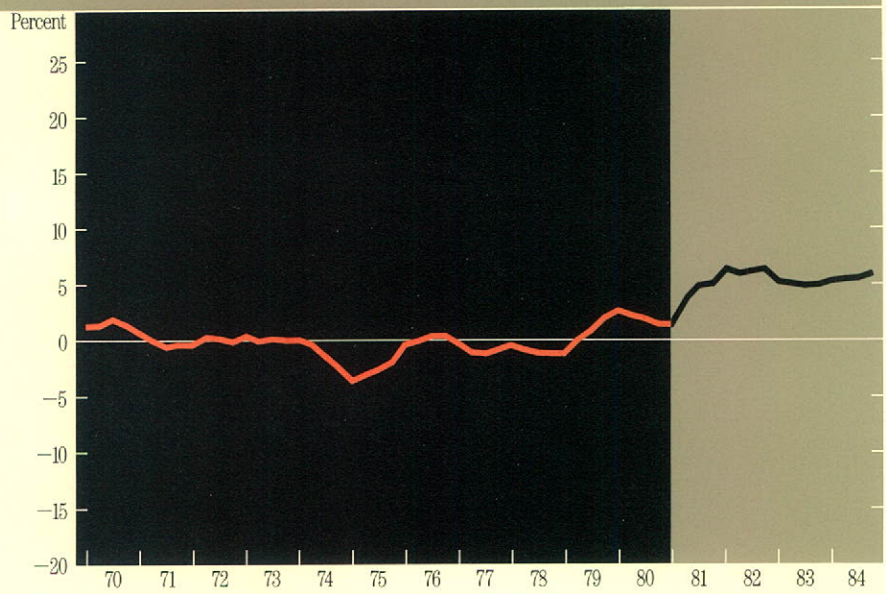
Despite these positive factors, we cannot be complacent about our economic prospects or about the public policy challenges we face. Indeed, it is increasingly recognized that some sectors of the economy, here and abroad, have participated little, if at all, in the recovery to date. These sectors generally are not suffering from depressed sales volume, for in virtually all cases the increases in their output and/or sales in this recovery compare favorably with their performance in previous postwar expansions. Even in the mining and farm equipment sectors—two industries hit hard by the recession—production has improved significantly relative to its recession trough.

Comparisons of this nature imply that lagging output is not the problem in many of these industries. This view is reinforced by the fact that around the world industries, financial intermediaries, and, indeed, countries continue to face serious financial problems, even though their lot should have improved materially with the pickup in economic activity worldwide. One factor that most, if not all, of these institutions and organizations have in common is that to a degree they counted on a continuation of high inflation to validate investment decisions, lending policies, or growth strategies. As inflation diminished and subsequently remained modest, this validation did not occur, thereby contributing to their woes. The ongoing financial problems of many developing countries can be traced, for example, to their dependence on commodity exports—metals or agricultural products—where prices have held steady or have fallen in recent years.

The implication of this argument is not that the reduction in inflation that has been achieved was ill-advised or that, in any event, inflation ought now be permitted to rise. The inability of an advanced industrialized economy such as ours to function well in an inflationary environment has been documented and demonstrated by the experience of the 1970s and early 1980s, so that this alternative offers no promise at all. The implication, rather, is that the transition—the adjustment—to low inflation was bound to be difficult and costly for those participants who did not expect it and did not act accordingly. This statement holds for those investors or enterprises who counted on constant appreciation of land and real estate values or of prices of oil and other raw materials, and for those who financed such plans and investments.

In these instances, however, the difficulties in the ongoing transition to low inflation have been exacerbated by the exceedingly high levels of real interest rates (i.e., inflation adjusted) that have characterized the recovery (see Chart 2). These high real rates constitute substantial burdens to borrowers, particularly in sectors like agriculture and energy where product prices have not kept pace in recent years with the overall price level, so that the real rates confronted by producers in these sectors have been exceedingly high (see, for example, Chart 3). The debt situation has been further strained in those cases where the value of the underlying asset has decreased so that the loan cannot

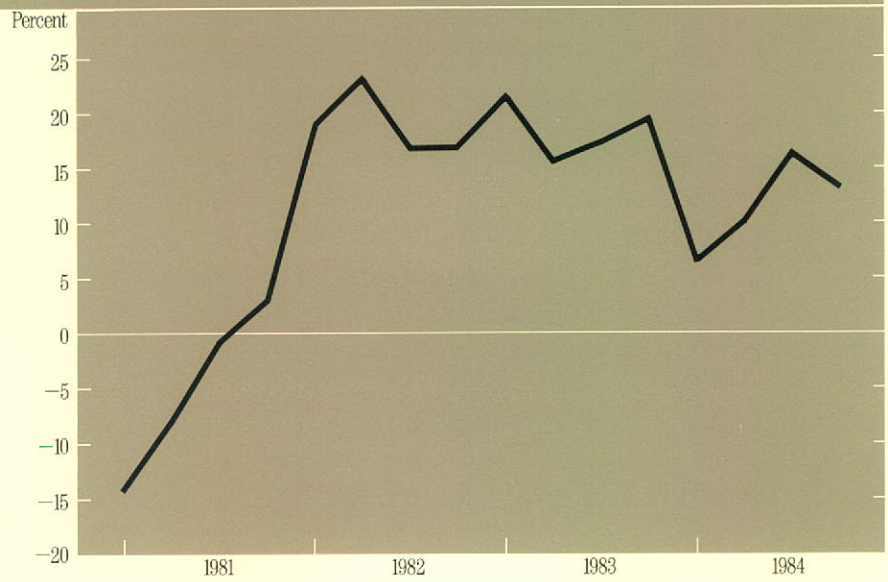
Chart 2 Inflation Adjusted Interest Rate for the U.S. Economy, 1970-1984



Difference between four quarter moving average in the three month Treasury bill rate and the four quarter percent change in the gross national product (GNP) implicit price deflator.

Source: U.S. Department of Treasury and U.S. Department of Commerce, Bureau of Economic Analysis

Chart 3 Inflation Adjusted Interest Rate for the Petroleum Refining Sector, 1981-1984



Difference between four quarter moving average in the three month Treasury bill rate and the four quarter percent change in the producer price index for refined petroleum products.

Source: U.S. Department of Treasury and U.S. Department of Labor, Bureau of Labor Statistics

be retired by the sale of the asset. Lenders on the other side of these transactions are not necessarily in a significantly better position, for they may hold financial assets of questionable value. In such cases, obtaining the underlying real asset through foreclosure will not prevent significant loan losses for the financial institution.

Ramifications of High Real Rates

As the economic recovery has proceeded and as inflation has remained subdued, the costs associated with these high real interest rates are becoming increasingly difficult to accept. Such rates are imposing high costs on specific sectors of the economy, costs which are related to, but which go beyond, the financial implications already discussed.

Specifically, these interest rates have contributed to the persistent strength of the dollar relative to other major currencies throughout the world. The linkage would seem to be rather direct, in that investment returns have been attractive in this country relative to the rest of the world, particularly as inflation has remained moderate. To be sure, domestic interest rates have not been the only factor responsible for the ongoing strength of the dollar. Political stability and commitment to capitalism—ingredients in the so-called safe haven phenomenon—have served to bolster the dollar, as have the relatively robust pace of our domestic economic expansion, the attendant growth in profits and, equally important, the opportunities for profit.

The shift into dollar denominated assets was inevitable, given the scale of the foreign trade and current account deficits the United States has run over the past two years (see Table 1). Between 1977 and 1982, the U.S. merchandise trade deficit generally remained between $25 billion and $37 billion per year, or roughly 1 percent of GNP. But the trade deficit in 1983 exceeded $60 billion, and in 1984 it topped $100 billion—nearly 3 percent of GNP. Our current account balance—a broader measure of international transactions which, in addition to the trade figures, includes investment income, military transactions, and certain transfer payments and U.S. government grants—depicts this situation even more graphically. Between 1977 and 1982, the cumulative U.S. deficit on current account was about $32 billion. But in 1983 alone, this deficit came to more than $40 billion, and in 1984 it totaled about $100 billion.

Several factors have contributed to this trade and current account performance. The strength of the economic expansion here, compared to that under way in many of the other industrialized countries of the world, has been a significant factor because demands for goods and services have grown appreciably more rapidly here than abroad. Then, too, the financial straits faced by several large developing countries—countries that in the past have

Table 1 U.S. Trade and Current Account Balances as a Percent of Gross National Product (GNP), 1977-1984

	Merchandise Trade Balance ($ Bil.)	Merchandise Trade Balance as Percent of GNP	Current Account Balance ($ Bil.)	Current Account Balance as Percent of GNP
1977	− 31.1	1.6%	− 14.5	1.0%
1978	− 34.0	1.6%	− 15.4	1.0%
1979	− 27.6	1.1%	− 1.0	—
1980	− 25.5	1.0%	1.9	—
1981	− 28.0	1.0%	6.3	—
1982	− 36.5	1.1%	− 9.2	—
1983	− 61.1	1.8%	− 41.6	1.3%
1984	−107.6	2.9%	−101.7	2.8%

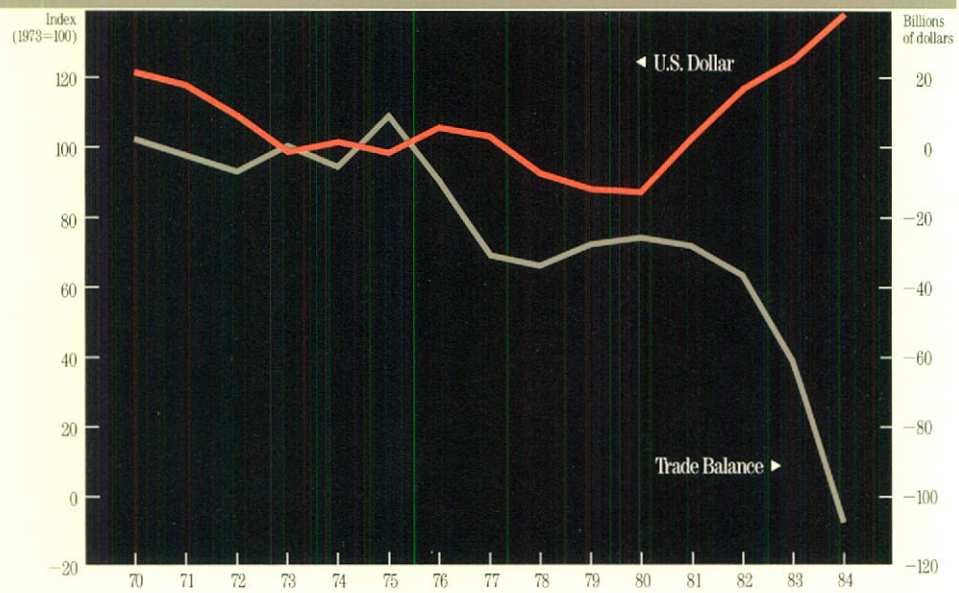
Source: U.S. Department of Commerce, Bureau of Economic Analysis

represented important markets for U.S. exports—have led to curtailment of their ability to import, thereby depressing our exports.

But, undeniably, the persistent strength of the dollar relative to other major currencies has been a prime factor in our trade performance. The rise of the dollar has meant that goods produced here have become increasingly expensive in terms of foreign currencies, while goods produced abroad have become increasingly inexpensive in terms of dollars. Taken all together—our strong domestic recovery, the financial problems of developing countries, and the strength of the dollar—the result is trade and current account imbalances of unprecedented proportions (see Chart 4).

The impact of this situation on our economy should not be underestimated. Sectors that have faced this foreign competition directly or indirectly, or that traditionally have relied on an ability to export for revenues and profits, have encountered serious difficulties even as the recovery has proceeded. As previously noted, this has been more a problem of price than of volume. Whatever the source, these problems at times spread beyond the specific industries in question because of the consequences for their suppliers and communities. Further, to the extent that problems spill over into our financial institutions, as they clearly do when borrowers are unable to meet their commitments and obligations, they can have ramifications that transcend industrial or geographic boundaries. This is because the worldwide financial community is so tightly knit that a problem in one major institution or with one large debtor potentially can be transmitted to other institutions in very short order.

Chart 4 Exchange Value of the U.S. Dollar and U.S. Merchandise Trade Balance, 1970-1984



Source: U.S. Department of Commerce, Bureau of Economic Analysis, and Board of Governors of the Federal Reserve System

The Role of the Deficit

The financial and foreign trade aspects of high real interest rates, then, have exacerbated the difficulties associated with the adjustment to low inflation. In turn, these real rates can be traced in part, through a number of channels, to the federal budgetary situation. The origins and magnitude of these budget deficits, as well as the frustrations encountered in trying to come to grips with them, are by now well known and will not be repeated here. Suffice it to say that deficits in the neighborhood of $200 billion or more annually loom for the balance of the decade, given current federal spending and tax policies. Even with reasonably optimistic assumptions about economic growth over this period, it has become increasingly clear that these deficits will persist unless overt policy action is taken to deal with them.

In a direct way, the deficits require sizable, ongoing borrowing by the Treasury, thereby adding materially to overall demands for credit in an environment in which the private sector is bidding vigorously for funds as well. Taken by itself, this situation suggests a high real interest rate environment. Less directly, budget deficits of the magnitude now in prospect also raise the spectre of a potentially significant reacceleration of inflation at some point in the future. This concern is particularly acute if unbridled government borrowing results in a more accommodative monetary policy than the Federal

Reserve prefers or the economy needs. Thus, both because of concerns about future inflation and because of pressing current demands for financing, the deficits are a material factor—although certainly not the only factor—contributing to prevailing interest rate levels.

To the extent that these interest rates have helped to attract capital from abroad and to strengthen the dollar, financing the deficit to this point has not been as difficult as it might have been. But, in view of the magnitude of our present current account deficit and taking a hard look at our international prospects, it seems likely that the United States could soon become the largest debtor country in the world. This observation need not automatically trigger alarm, but in an environment in which real interest rate levels exceed our economy's ability to grow, servicing this debt and managing the federal deficit situation will prove increasingly burdensome.

Policy Prescriptions

In our judgment, the current state of affairs—characterized by high federal budget and foreign trade deficits—imposes disproportionate costs on some sectors and institutions in the economy and is not sustainable in the long run. This situation is not sustainable because the costs associated with these deficits are mounting, threatening at some point to trigger actions which could jeopardize progress in reducing inflation and in maintaining growth and prosperity. For example, pressure to reduce high real interest rates presumably could be alleviated by excessive monetary expansion, but such action would lead to a reacceleration of inflation, in the process sacrificing one of the principal objectives of public policy.

Similarly, the imbalance in our international accounts could provoke a widespread protectionist reaction in this country. Pervasive protectionist measures curtail the access of foreign goods to our markets, thereby distorting resource allocation and contributing to higher prices. Both directly, by reducing capacity and sources of supply, and indirectly, by the signal that would at least implicitly be sent to domestic producers, protectionism would raise the spectre of more inflation. Moreover, it is questionable whether any benefit would result from protectionism. One reaction to broad based protectionist policies here could be a hardening of trade restrictions abroad, so that our export industries would encounter even tougher sledding in world markets.

Financing the federal budget deficit could also prove increasingly difficult over time, particularly if there is a change in economic policies abroad. Domestic deficit finance has been aided by significant capital inflows, but if foreign countries act to curtail these flows—through, say, more expansionary fiscal policies of their own and higher interest rates—increases in rates could be required here to attract the funds necessary to cover the budget gap.

Higher rates, of course, would weaken the expansion as interest sensitive sectors of our economy slowed. At least from the perspective of aggregate activity, crowding out has largely been avoided thus far in the recovery, but this problem could become far more serious if dependence on foreign capital continues and attitudes and policies abroad change.

Even if these international considerations are ignored, the federal budget deficit poses a distinct threat to progress toward reasonable price stability. An overly stimulative fiscal policy sooner or later runs the risk of triggering a reacceleration of price increases because it may contribute to a buildup of demand which outstrips the growth over time in capacity and supply. As noted earlier, this danger is particularly grave if, as a result of large and persistent budget deficits and the interest rate levels they help to engender, monetary policy is maneuvered into a more accommodative posture than it would otherwise adopt.

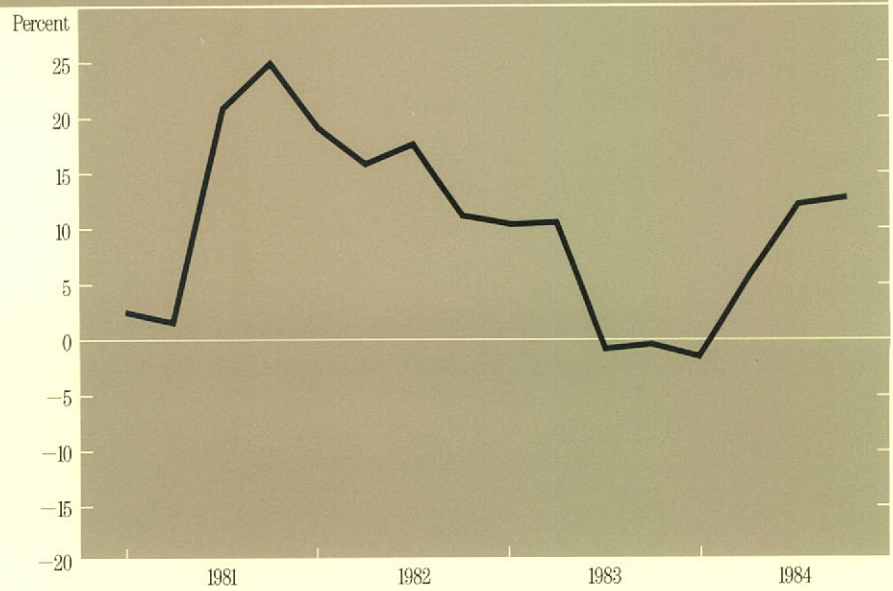
Any effort, then, to construct and implement policies that will contribute to sustainable growth with low inflation must include meaningful reductions in prospective federal deficits. Such reductions should contribute to more reasonable levels of real interest rates, which in turn would ease financial pressures on economic sectors here and abroad. The threat of crowding out in our domestic economy should diminish. And while it is by no means certain that our international competitive situation would improve, if the dollar were to decline modestly relative to other major currencies as a consequence of lower real interest rates, our foreign trade position could in fact be bolstered.

Implicit in the earlier discussion is a second key ingredient in helping to assure progress toward price stability—namely, continued discipline in the conduct of monetary policy. Absence of such discipline, or even signs that the Federal Reserve's commitment and resolve were wavering, could appreciably disrupt, if not compromise altogether, the effort to achieve enduring prosperity.

Even if these macroeconomic policies are pursued, it will obviously require time for deficit reduction to be implemented and to take effect. In the interim, many of the problems associated with high interest rates are likely to persist, especially for those sectors of the economy experiencing difficulty in making the transition to a low inflation environment. The question then arises whether it is appropriate to provide limited assistance to targeted sectors of the economy or to specific industries. Such limited assistance programs might be considered on the basis of either equity or efficiency: if, for example, previous government policies contributed, perhaps inadvertently, to the problems these sectors are now experiencing; if potentially disorderly or chaotic sectoral adjustments raise concerns about systemic instability; or if alternative policy prescriptions threaten to impose even higher costs on the overall economy.

While there thus may be a role for policies or programs which provide assistance to particular sectors, such programs need to be designed and administered with a good deal of caution and careful judgment. The agri-

Chart 5 Inflation Adjusted Interest Rate for the Farm Sector, 1981-1984



Difference between four quarter moving average in the three month Treasury bill rate and the four quarter percent change in the producer price index for farm products.

Source: U.S. Department of Treasury and U.S. Department of Labor, Bureau of Labor Statistics

cultural sector of our economy provides a case in point. The transition to low inflation and the consequences of high real interest rates have hit this sector with particular force (see Chart 5). The decline in inflation has meant that expectations of upward trends in crop and livestock prices and of ever-escalating land values have not been realized. As a result, producers who acted on these assumptions have encountered mounting strains. In many regions, income from farming has been low and land prices have been falling. High real interest rates have meant that those with large debt burdens have experienced continuing difficulty in servicing this debt. Moreover, with the strong dollar, agricultural exports have been hindered and imported products have been attracted.

If the adjustment problems in agriculture, or in some other sector, are to be addressed with a series of targeted policies and programs, steps should be taken to minimize distortions to incentives and hence to resource allocation. Insofar as possible, reliance should be placed on the private sector, and case-by-case debt restructuring between borrower and lender should be encouraged. In this effort, there may be a place for private or public "seed money," but the remedial process must respond to and reward those debtors who demonstrate progress in putting their financial affairs in order. Moreover, in view of the overall federal budget deficit situation, it would seem advisable that there

be no aggregate increase in aid but rather a redirection or reorientation of assistance.

These considerations imply that any government program to assist agriculture must be limited in scope, magnitude, and duration, so that the private sector continues to function effectively, and the preponderance of the necessary changes in resource allocation still take place. Therefore, interest rate subsidies to farmers—a program that is functioning indirectly at the federal level and directly in at least one state—should be available only to those who meet strict eligibility requirements. Otherwise, attractive interest rates could draw additional resources into agriculture, a result that clearly is incompatible with prevailing conditions in the sector. Further, aid should be directed insofar as practicable to producers who could at least break even at more normal levels of real interest rates. While perhaps difficult to implement, this recommendation follows from concern about the precedent of saving those—in any sector—who grossly misjudge future trends in product prices and asset values. For those in this situation with little prospect of regaining profitability, retraining and relocation assistance may be better solutions.

Obviously, assistance programs should not add to the severity of the problems they are intended to address. One of the objections to the numerous debt moratorium proposals advanced at the state level is that they could keep unprofitable ventures going, leading over time to further erosion in owners' equity. As a consequence, if and as liquidation becomes unavoidable, the owner will obtain less than would have been the case in the absence of the moratorium. And programs clearly should not substantially counter the basic objectives of public policy. Higher price supports for agricultural products might in some sense solve the immediate problem, but at the cost of greater federal outlays, of higher domestic prices, of a less internationally competitive agricultural sector, and of ongoing resource misallocation. Such costs appear to be far too high. Further, assistance programs, as a general rule, should have well-defined sunset provisions since transitional, not permanent, assistance is the intent.

Whatever may be done along these lines, targeted policies will be unsuccessful unless there is sustained economic growth here and abroad. This observation reemphasizes the point that transitional policies are intended only to facilitate the adjustment process and are premised on the assumption that the underlying problem—in this case excessive federal deficits—will be addressed in a concrete and credible way.

Federal Reserve Bank of Minneapolis

Statement of Condition
Earnings and Expenses
Directors
Officers

Statement of Condition (In thousands)

	December 31, 1984	December 31, 1983
Assets		
Gold Certificate Account	$ 160,000	$ 143,000
Interdistrict Settlement Fund	(83,955)	328,907
Special Drawing Rights Certificate Account	61,000	61,000
Coin	15,570	20,373
Loans to Depository Institutions	6,750	48,900
Securities:		
Federal Agency Obligations	112,942	105,810
U.S. Government Securities	2,143,552	1,842,738
Total Securities	$2,256,494	$1,948,548
Cash Items in Process of Collection	421,498	469,262
Bank Premises and Equipment— Less: Depreciation of $18,496 and $15,322	34,407	35,503
Foreign Currencies	125,860	132,768
Other Assets	43,064	74,189
Total Assets	$3,040,688	$3,262,450
Liabilities		
Federal Reserve Notes[1]	$2,065,106	$2,296,437
Deposits:		
Depository Institutions	451,444	393,522
Foreign	5,250	5,400
Other Deposits	4,727	3,459
Total Deposits	$ 461,421	$ 402,381
Deferred Availability	363,293	430,860
Other Liabilities	42,260	31,730
Total Liabilities	$2,932,080	$3,161,408
Capital Accounts		
Capital Paid In	$ 54,304	$ 50,521
Surplus	54,304	50,521
Total Capital Accounts	$ 108,608	$ 101,042
Total Liabilities and Capital Accounts	$3,040,688	$3,262,450

[1]Amount is net of notes held by the Bank: $520 million in 1984; and $504 million in 1983.

Earnings and Expenses (In thousands)

For the Year Ended December 31	1984	1983
Current Earnings		
Interest on Loans to Depository Institutions	$ 4,427	$ 3,037
Interest on U.S. Government Securities and Federal Agency Obligations	217,452	186,220
Earnings on Foreign Currency	7,609	9,857
Revenue from Priced Services	32,795	28,609
All Other Earnings	441	167
Total Current Earnings	$262,724	$227,890
Current Expenses		
Salaries and Other Personnel Expenses	$ 25,023	$ 23,642
Retirement and Other Benefits	6,054	6,155
Travel	961	894
Postage and Shipping	4,819	5,120
Communications	982	993
Materials and Supplies	1,636	1,562
Real Estate Taxes	2,160	2,158
Depreciation—Bank Premises	1,041	1,005
Utilities	892	842
Furniture and Operating Equipment—		
Rentals	2,336	2,264
Depreciation and Miscellaneous Purchases	3,053	1,897
Repairs and Maintenance	1,158	935
Cost of Earnings Credits	6,941	4,049
Other Operating Expenses	1,995	2,548
Net Shared Costs Received from Other FR Banks	1,488	1,154
Total	$ 60,539	$ 55,218
Reimbursed Expenses[2]	(2,720)	(2,522)
Net Expenses	$ 57,819	$ 52,696
Current Net Earnings	$204,905	$175,194
Net Deductions[3]	15,598	16,165
Less:		
Assessment by Board of Governors:		
Board Expenditures	2,837	2,560
Federal Reserve Currency Costs	2,372	3,125
Dividends Paid	3,193	2,983
Payments to U.S. Treasury	177,122	148,824
Transferred to Surplus	$ 3,783	$ 1,537
Surplus Account		
Surplus, January 1	$ 50,521	$ 48,984
Transferred to Surplus—as above	3,783	1,537
Surplus, December 31	$ 54,304	$ 50,521

[2]Reimbursements received from the U.S. Treasury and other federal agencies.

[3]This item mainly consists of unrealized net losses related to revaluation of assets denominated in foreign currencies to market exchange rates.

Directors Federal Reserve Bank of Minneapolis December 31, 1984

William G. Phillips
Chairman and Federal Reserve Agent

John B. Davis, Jr.
Deputy Chairman

Class A Elected by Member Banks — Term Expires December 31

Dale W. Fern
Chairman and President, First National Bank, Baldwin, Wisconsin — 1984

Curtis W. Kuehn
President, First National Bank, Sioux Falls, South Dakota — 1985

Burton P. Allen, Jr.
President, First National Bank, Milaca, Minnesota — 1986

Class B Elected by Member Banks

William L. Mathers
President, Mathers Land Company, Inc., Miles City, Montana — 1984

Richard L. Falconer
District Manager, Northwestern Bell, Bismarck, North Dakota — 1985

Harold F. Zigmund
Retired Chairman, Blandin Paper Company, Grand Rapids, Minnesota — 1986

Class C Appointed by Board of Governors

William G. Phillips
Chairman, International Multifoods, Minneapolis, Minnesota — 1984

Sister Generose Gervais
Executive Director, Saint Marys Hospital, Rochester, Minnesota — 1985

John B. Davis, Jr.
Interim Executive Director, Children's Theatre Company and School, Minneapolis, Minnesota — 1986

Member of Federal Advisory Council

E. Peter Gillette, Jr.
Vice Chairman, Norwest Corporation, Minneapolis, Minnesota — 1984

Helena Branch

Ernest B. Corrick
Chairman

Gene J. Etchart
Vice Chairman

Appointed by Board of Directors FRB of Minneapolis

Harry W. Newlon
President, First National Bank, Bozeman, Montana — 1984

Seabrook Pates
President, Midland Implement Company, Inc., Billings, Montana — 1984

Roger H. Ulrich
President, First State Bank, Malta, Montana — 1985

Appointed by Board of Governors

Ernest B. Corrick
Vice President and General Manager, Champion International Corporation, Timberlands-Rocky Mountain Operations, Milltown, Montana — 1984

Gene J. Etchart
Past President, Hinsdale Livestock Company, Glasgow, Montana — 1985

Officers Federal Reserve Bank of Minneapolis December 31, 1984

E. Gerald Corrigan	*President*
Thomas E. Gainor	*First Vice President*
Melvin L. Burstein	*Senior Vice President and General Counsel*
Leonard W. Fernelius	*Senior Vice President*
Gary H. Stern	*Senior Vice President and Director of Research*
Sheldon L. Azine	*Vice President and Deputy General Counsel*
Lester G. Gable	*Vice President*
Phil C. Gerber	*Vice President*
Bruce J. Hedblom	*Vice President*
Douglas R. Hellweg	*Vice President*
Ronald E. Kaatz	*Vice President*
David R. McDonald	*Vice President*
Preston J. Miller	*Monetary Adviser*
Clarence W. Nelson	*Vice President and Economic Adviser*
Arthur J. Rolnick	*Vice President and Deputy Director of Research*
Charles L. Shromoff	*General Auditor*
Colleen K. Strand	*Vice President*
Theodore E. Umhoefer, Jr.	*Vice President*
Kathleen J. Balkman	*Assistant Vice President and Secretary*
John H. Boyd	*Assistant Vice President*
Robert C. Brandt	*Assistant Vice President*
James U. Brooks	*Assistant Vice President*
Marilyn L. Brown	*Assistant General Auditor*
Evelyn F. Carroll	*Assistant Vice President*
Richard K. Einan	*Assistant Vice President and Community Affairs Officer*
Jean C. Garrick	*Assistant Vice President*
Caryl W. Hayward	*Assistant Vice President*
William B. Holm	*Assistant Vice President*
Ronald O. Hostad	*Assistant Vice President*
Bruce H. Johnson	*Assistant Vice President*
Thomas E. Kleinschmit	*Assistant Vice President*
Richard L. Kuxhausen	*Assistant Vice President*
Roderick A. Long	*Assistant Vice President*
James M. Lyon	*Assistant Vice President*
Susan J. Manchester	*Assistant Vice President*
Richard W. Puttin	*Assistant Vice President*
Thomas M. Supel	*Assistant Vice President*
Kenneth C. Theisen	*Assistant Vice President*
Thomas H. Turner	*Assistant Vice President*
Carolyn A. Verret	*Assistant Vice President*
Joseph R. Vogel	*Chief Examiner*
William G. Wurster	*Assistant Vice President*

Helena Branch

Robert F. McNellis	*Vice President and Manager*

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