STATEMENT OF THE BOARD OF GOVERNOS OF THE
FEDERAL RESERVE SYSTEM

July 30, 1937

OBJECTIVES OF MONETARY POLICY

From time to time the Board of Governors of the Federal Reserve System is asked for its opinion of bills pending in Congress that would establish a central monetary authority and direct it, as a primary objective, to achieve and maintain a specified domestic price level. In these bills it is generally assumed that the stated objective may be attained exclusively through monetary control, and responsibility for accomplishing the end sought is, therefore, placed upon the monetary authority.

The Board assumes that, while price stabilization is stated as the objective of such proposals, the authors regard stability of prices merely as a means toward a more important end, namely, the lessening of booms and depressions and the increase in the national output and well-being, in the belief that through the maintenance of a stable price level the broader objective will be achieved.

The Board is in full agreement with the ultimate objective of the proposals to promote economic stability, which means the maintenance of as full employment of labor and of the productive capacity of the country as can be continuously sustained. The Board, with the broader powers conferred upon it by the Banking Act of 1935, performs essential functions necessary to the achievement of this objective.

As to the adequacy and efficacy of the means provided by the proposals to achieve this objective, the conclusions reached by the Board are briefly stated in the following discussion.

Price stabilization not an adequate objective. That wide fluctuations in the price level are disastrous is beyond question and determined efforts should be made to prevent such fluctuations as would endanger economic stability. The Board is convinced, however, that the broader objective of maximum sustainable utilization of the nation's resources cannot be achieved by attempting to maintain a fixed level of prices, and that, therefore, price stability should not be the sole or principal objective of monetary policy.

Stabilization of individual prices by monetary means is not proposed, nor would it be feasible. Proposals for price stability necessarily refer to some index or average of prices. There is no general agreement on the question of what constitutes a satisfactory price index for this purpose, although the general wholesale commodity price index is often suggested.

No matter what price index may be adopted as a guide, unstable economic conditions may develop, as they did in the 1920's, while the price level remains stable; business activity can change in one direction or the other and acquire considerable momentum before the changes are reflected in the index of prices. There are situations in which changes in the price level would work toward maintenance of stability; declining prices resulting from technological improvements, for example, may contribute to stability by increasing consumption. There are other situations when the restoration and maintenance of relatively full employment may be possible only with an advance in prices. Correspondence between price stability and economic stability is not sufficiently close, therefore, to make it desirable to restrict the objective of monetary policy to price stability.

The inadequacy of price stability as a guide to policy may be illustrated by a situation when the index rises owing to an advance in agricultural prices. Such a rise might result from a crop failure in the United States, or from a short world crop while the harvest in this country was bountiful and full employment prevailed. If the maintenance of a fixed price level were the sole guide to monetary policy, a restraining policy would be indicated in both cases, although in the former case such a policy might result in a general business decline, while in the latter case it might or might not be justified depending on other circumstances.

Inasmuch as the management of the country's monetary system is not an exact science, since it involves forecasting and dealing with many uncertainties, it is essential in determining an objective to leave scope for judgment and discretion.

Monetary contribution to economic stability. Monetary authorities may contribute to economic stability by exerting an influence to maintain a flow of funds conducive to as full a use of the country's productive resources as can be continuously sustained and to keep the banking machinery of the country in sound condition. The Board recognizes that even an adequate supply of money will not perform its functions adequately, if the banking structure through which it must operate is in an unsound condition, and that a sound banking structure cannot be sustained if the supply of money is insufficient, and a deflation is under way. The Federal Reserve System, therefore, must work toward economic stability through its influence both on the flow of money and on the soundness of banking conditions. The Board is aware of the limitations on the effectiveness of this influence which arise from the multiplicity of laws and jurisdictions as well as from the divided responsibility for supervision under which the banks of this country function.

Monetary control alone cannot accomplish economic stability. An attempt to make either price stability or the broader objective of economic stability the particular concern of the Federal Reserve System, without recognizing the fact that the attainment of the objective would require the cooperation of other agencies of the Government, is impractical.

The Federal Reserve System can regulate within limits the supply of money but there are other factors affecting prices and business activity fully as powerful as the money supply. Many of these factors are non-monetary and cannot be controlled by monetary action. Their effect on business activity may express itself in an increased or decreased rate of use, or turnover, of the existing supply of money as well as in a change in the supply itself. The influence that the Federal Reserve System can exercise over the interest rate has an important bearing on business activity, but it may be entirely offset by other factors.

It is essential to recognize the limitations on the effectiveness of monetary policy. Monetary factors are only one of the groups of forces affecting business activity.

Conclusion. To sum up, the Board believes that economic stability rather than price stability should be the general objective of public policy. It is convinced that this objective cannot be achieved by monetary policy alone, but that the goal should be sought through co-ordination of monetary and other major policies of the government which influence business activity, including particularly policies with respect to taxation, expenditures, lending, foreign trade, agriculture and labor.

It should be the declared objective of the Government of the United States to maintain economic stability, and it should be the recognized duty of the Board of Governors of the Federal Reserve System to use all its powers to contribute to a concerted effort by all agencies of the Government toward the attainment of this objective.