

CONFIDENTIAL

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMORANDUM

September 19, 1949

To: *Governor Eccles*

From: Woodlief Thomas

Attached is a copy of replies to the general questionnaire of the Joint Committee on the Economic Report on effectiveness and coordination of monetary, credit, and fiscal policies submitted by Seymour Harris, Professor of Economics at Harvard University. These answers are particularly well expressed and many of them are original and uninhibited. I am sending a copy to you with the thought that it might be of interest and helpful in considering our answers to similar questions.

This, of course, should not be given any outside circulation.

September 15, 1949

Replies to the Questionnaire of the Joint Committee on the Economic Report
on Effectiveness and Coordination of Monetary, Credit, and Fiscal Policies
(Senator Douglas, Chairman)

by

Seymour E. Harris
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1. What should be the guideposts and objectives of monetary and credit policies? For example, in formulating these policies what consideration should be given to the behavior of general price levels, to individual prices, to employment, to interest rates, and so on? What are your major criticisms, if any, of the guideposts and objectives of our monetary and credit policies in the past?

The guidepost of monetary policy should be the attainment of a stable and growing economy. Those responsible should watch gold flows, monetary supplies, exchange rates, prices and the rate of interest as factors influencing economic conditions; and output, employment and unemployment, as high output and employment and low unemployment are the ultimate objectives of monetary policies.

In general, the Monetary Authority should try to keep interest rates low as a stimulus to business activity. The twenties were the 4 per cent decade, the thirties, the 3 per cent decade, and the forties, the 2 per cent decade. By depressing interest rates in these 20 years, Monetary Authorities have contributed to a higher level of activity. This does not mean that recourse should not be had to higher rates of interest in periods of exuberance; but that policy, because of its cumulative effects, should be used with extreme caution.

Prices are a symptom to be watched at all times. Not only commodity, but all prices. The mistake of watching commodity prices alone accounts in part for the fiasco of the twenties; for with commodity prices stable, security prices rose spectacularly. Inflation and excessive expansion stem in part from the relation of prices and costs. Stable prices are consistent with high profits and strong inflationary pressures, when costs are falling. Again, consider the relation of prices and costs in the twenties. This suggests that the Monetary Authority should watch not alone prices, but also costs (inclusive of wage rates) and profits. Since this country can expect a rise of 2-3 per cent in man-hour output yearly, a stable economy requires falling prices or (and) rising wages of corresponding proportions.

Output, employment and unemployment are barometers of success and failure of monetary policy. In an economy which advances with rising population and productivity, output should rise. A decline or inadequate rise suggests a stumbling economy. But a rise in output is not enough.

Rising output should also register an increase in employment which will absorb a half million or more new workers each year. A large rise of output is consistent with declining employment in an economy which becomes increasingly productive.

These then are the guideposts and objectives. And monetary policy should be oriented to them. That does not mean that failure to achieve both stability and growth is necessarily the fault of the Monetary Authority (M.A.).

It is possible to put too great a burden on the M.A. A highly inflationary wage or profit or farm policy, or a highly deflationary one resulting in inflation or deflation is not the responsibility primarily of the M.A. Indeed the M.A. may to some extent try to offset errors in income policy; but in an inflation period, it is not easy to starve the economy and bring about a collapse; and in the deflation period, the task of extricating the economy from the deflation quagmire is likely to prove too much. The M.A. may provide the monetary supplies appropriate for a stable and growing economy; but no monetary policy will stabilize the economy if, for example, labor asks for a 10 per cent rise in wage rates annually; or business raises its profits by 50 per cent each year.

In the past, the M.A. has been too concerned with commodity prices, to the exclusion of general prices, costs and employment conditions. This is, however, an advance over the 19th Century when at one time government took no responsibility for monetary supplies -- e.g., the Jackson removal and hoarding of cash in a rising economy; or when in the third quarter of the 19th Century, the main objective was to keep the banks solvent, not to prevent price collapses or provide the country with adequate supplies of money. The repayment of two thirds of the national debt, for example, was an accomplishment in the generation following the Civil War, which squeezed the debtor class and raised serious economic and political problems. Again, in the twenties, there was so much concern with price stabilization, that the action to curb the inflation of investment and security prices was tardy and indecisive. A substantial tax reduction, which slowed up debt repayment, aggravated the problems of the M.A. and reflected weakness of coordination. In the thirties, the emphasis was still too much on monetary supplies, and not on demand for money and employment. In the forties, the interests of government in monetary expansion and low rate of interest took precedence; but more attention should have been paid to price movements and excessive investment.

2. In formulating its policies, what attention should the Federal Reserve give to interest charges on the Government debt and to the prices of Government securities? What should be the guiding principles for any Federal Reserve actions relating to the yields and prices of Government securities?

Obviously interest rates on government securities are a matter of major importance, for the country and, therefore, in formulating policies, the Federal Reserve should consider the effects of its policies on these **rates.**