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### CURRENT ISSUES IN MONETARY POLICY

Anyone reading the newspapers, listening to discussion of economic affairs or following professional economic literature today can detect three broad issues in connection with monetary policy. Two of these are current in the sense that they are being discussed widely today, but they can almost be classed as perennial for they have been equally widely discussed on many occasions in the past. The third is really current in the sense that it concerns the immediate scene.

The two that are both current and perennial may be stated about as follows:

(a) Monetary policy, like broad economic policy, claims to be concerned with economic growth, high employment and price stability. Are not these goals inconsistent and irreconcilable? Is it possible to have both growth and high employment along with a stable price level?

(b) Is monetary policy really powerful enough to achieve its ends? Granted the desirability of its objectives, can not they be obtained more efficiently by other methods? Can monetary policy do its job?

The third broad issue I call current in the immediate sense may be expressed about like this:

(c) Granted that monetary policy can do its job is it really doing it correctly? Is current, or for that matter past, monetary policy in the right posture; is policy well-conceived and well-implemented?

There are, of course, variations on these themes but they all seem to come down to the above three issues as being the central issues. I propose to discuss them in the order which I have given them.

### The Objectives of Policy

In discussing these objectives of policy, I believe it will be useful to cite a bit of the record on growth and prices and to consider what we are talking about when we use the terms "growth" and "price stability".

Perhaps the two most important things to note about economic growth records are these. First, the very long-term picture shows an average rate of growth in this country of about 3 per cent per year compounded. This is the record of the whole of the Twentieth Century to date. That rate is equivalent to doubling real output every 25 years. Second, this is an average rate of growth, and growth in any one, two, or several year period may be substantially higher or lower than average. Thus we showed a growth rate of about 8 per cent in 1951, and of about 4 per cent in each of the next two years. In 1954, output was 2 per cent less than in 1953, but in 1955 it expanded by 8 per cent again. Growth in both 1956 and 1957 was below average, and in 1958 output declined. The expected rise in 1959 is well above average. The postwar average as a whole is somewhat better than the average for the past 60 years.

Growth involves both the capacity to produce and the capacity to consume. We get physical output of goods and services by applying human brains and muscle to natural resources. As we improve the efficiency of this human energy through better technology and by developing capital, we increase productivity. To develop the capital we have to have saving - deferring consumption today so as to have more tomorrow.

This process simply is not a smooth one. We seem to get our technological improvements in waves; we get changes in the rate of saving and of capital formation; we even get changes in the rate of population growth. We can make some adjustments to compensate for the strong ups and downs of these factors but we cannot, nor do I think we ever will, smooth out the growth curve completely.

One important point to be made here is that the consumption side of growth is important. It is not enough to have capacity to produce goods and services; we have to have effective demand for these goods and services. While economics teaches us that man's wants are insatiable, it has never taught that man's want for any particular or specific good or service is insatiable. This is as true for public as it is for private goods and services. And this means that we have to have balanced growth in demand to accompany the growth in capacity to produce. If we fail to attain balance or equilibrium, we will find instances where we have too much or too little capacity or too much or too little demand. These instances, as illustrated by behavior over the past three years, produce inflationary tendencies or recession.

Let us turn now to look at the price record over the long term. Again it is necessary to use some figures to make the points clear. If we take the period from 1934 through 1958, we find that wholesale prices have advanced 145 per cent and consumer prices 116 per cent in that 24 years. This same period saw the Gross National Product expand by 186 per cent in constant dollars. About nine-tenths of the wholesale price rise and almost four-fifths of the consumer price rise occurred between 1939 and 1951. This, of course, is the period that saw the defense build-up, World War II and its aftermath, and Korea. Or to turn the example around, only one-tenth of the wholesale price rise and one-fifth of the consumer price rise took place in peacetime, classing the present cold war period as peacetime. In contrast to this, 40 per cent of the gain in real output occurred in peacetime and just 60 per cent in the years 1939-51.

It seems to me that there is little, if anything, in this record to indicate a causal connection between inflation and growth. Of course,

general economic theory and history both lead to the conclusion that inflation tends to work against rather than for growth, and the record is consistent with that conclusion. The evil effects of inflation have been cited so often in recent years that they need be given but brief mention here. The adverse effect on saving, which is required to finance the capital investment on which growth is based; the tendency toward speculation and unwise or unwarranted expansion; the upward push of costs which tends to price goods out of reach of those who do not share equally in the inflation and thus weakens markets; the social inequities of rapid shifts in income patterns: all are well known developments. None of these can be argued logically as being promoters of growth, their actions naturally would seem to inhibit growth. Thus the fact that the record shows occasions when we have had both growth and inflation would seem to indicate at best, coincidence.

The record also seems to show that control of inflation is by no means a hopeless task. Particularly in the period from 1951 through early 1956, when there was substantial growth without appreciable inflation, does the record give encouragement. Actually the whole postwar period from 1948 on looks fairly good, even though there was a Korean War and a major defense program continues still.

Perhaps it would be desirable at this point to come a little closer to defining price stability than has been done so far in this talk. Price stability does not mean price rigidity nor does it mean that individual prices should stay constant. Our kind of market economy calls for the price mechanism to allocate resources by reflecting the cross-effects of demand and supply. As changes in particular demands and supplies constantly occur, this allocation process cannot take place unless individual prices have some flexibility. The general level of prices, however, should stay relatively stable. It can

register moderate ups and downs over reasonable periods of time without detracting too much from the general beneficence of stability. The key point is that prices should not move rapidly or constantly in either direction.

What I have tried to show here is that there is no inconsistency in pursuing the goals of growth, high employment and price stability. On the contrary it is inconsistent to pursue any one or two of these and ignore the other. In fact, such a course is not only inconsistent but probably impossible of achievement.

We want a growing economy in this country; in fact, we have to have a growing economy to produce a high level of employment and to produce the volume of goods and services we need for a more abundant life, for an adequate defense establishment and for the host of public services we demand. We have the basis for such an economy, we have the resources and the technology to grow in the future at an even higher rate than in the past.

#### The Efficiency of Policy

I do not think we need to spend a great deal of time on this point. Critics in this field take, quite often simultaneously, two almost completely opposing points of view. On the one hand it is asserted that monetary policy is completely ineffective and on the other hand that it is so powerful that it should not be used. Neither position is valid.

No one connected with monetary policy asserts that it can achieve all objectives of economic policy all by itself under all kinds of conditions. It is no economic panacea. What it is is an impersonal and indirect kind of economic stabilizer that is important in our kind of economy but which is just one of several tools of importance.

Ralph Young of the Board's staff recently testified before the Senate Subcommittee on Anti-Trust and Monopoly. Included in his statement were the following paragraphs on the role of monetary policy in the economy.

"Monetary policy works to achieve these objectives by utilizing tools that affect the reserve position of commercial banks and, therefore, the total volume and cost of money and credit in the economy. Changes in the volume and cost of money and credit influence the economy through their direct impact on aggregate expenditure and their indirect influence on the climate for investment. The immediate effect of monetary changes is on spending financed by credit. Credit-financed outlays tend to fluctuate more widely over the cycle than most expenditures, partly because they are largely for semi-durable, durable, and capital-type goods, and for inventory of these goods. Expenditures for such goods, whether by producers or consumers, are by their nature postponable. Thus, variations in purchases financed by borrowed funds tend to have strategic effects on general levels of economic activity.

"The effects of monetary and credit policy flow from the application of general monetary instruments. These influences are indirect and impersonal. Monetary policy is not in a position to determine the demand for soup or soap, cars or carpenters. It functions best in providing an environment or climate in which the decisions made by individuals on the basis of market principles will be consistent with national economic objectives. If individual producers or sellers judge demands and tastes correctly in terms of price and quality, they reap the benefits. If they misjudge the market, they are obliged to readjust their productive operations. It is the responsibility of

each producer and seller to judge these things for himself and to adapt to shifting wants and needs as expressed in the market.

"Monetary policy, or for that matter other Government policy, can not and should not undertake to make market judgments or adaptations for individual producers. If monetary policy should undertake to finance whatever demands for credit are made upon the banking system, or permit itself to be used to 'justify' all decisions made by producers, whether correct or faulty, it would become an engine of inflation, not a force for stability and sustainable growth. Monetary policy must be concerned with the interests of all the people, consumers as well as producers, not with particular interests or industries.

"Obviously, monetary and credit policy can not do everything needed to attain stable growth; it must be supported by appropriate fiscal and other public policies, as well as by prudent private policies. During periods of expanding demands, accompanied by speculative psychology and expectations of creeping inflation, monetary policy has no option but to assume a restrictive posture. If it did not assume such a posture, widespread expectations that prices and costs would be steadily raised might indeed lead to further spiraling of costs and prices. Individual or group efforts then to hedge against or by escalation to protect against inflation would tend to aggravate inflationary forces rather than to bring them into balance."

One final point should be made on the efficiency of policy. While increases in the supply of money relative to the supply of goods and services are not followed on a one-to-one basis by increases in prices, the general tendency of prices to rise with undue increases in the supply of money is

supported by too much historical evidence to be denied. Thus assertions that we do not have to be concerned about the size of the money supply have little, if any, historical basis.