

to have some conception of the normal or proper credit conditions or degree of credit restraint that ought to prevail in the economy, and this they take it as their province to enforce.

Some of their statements suggest a curious fear of "sloppy money," of money market conditions easier than they take to be normal and proper. Therefore, when the economy weakens, when demands for credit fall off, interest rates naturally decline and banks insist upon having a more liquid balance sheet, the Federal Reserve frequently succumbs to the temptation to offset this by limiting the volume of bank reserves, thus causing the money supply to stop growing or to decline.

This approach is inherently destabilizing, since under it the money supply tends to grow most rapidly when the economy is strongest and to level off or decline when it is weak. This preoccupation with credit conditions to the exclusion of money has characterized the Federal Reserve since its inception, and its current theory seems to be a modern descendant of an ancient fallacy of banking theory known as the commercial loan theory of banking or the real bills doctrine.

Another element in the interpretative muddle over monetary policy is the meaning ascribed to changes in the amount of commercial bank time deposits, which have been increasing very rapidly recently. The Federal Reserve seems to hold that changes in time deposits have about the same effect on the economy as do changes in demand deposits or the money supply, in which case its record is not so restrictive as it otherwise appears.

For reasons that are rather abstruse, I think that this is an erroneous interpretation. Time deposits, which bear interest and are not means of payment, and which arise out of the demands of the holders, seem to play a fundamentally different role in the economy than money and are best treated as similar not to money but to other liquid assets. It is relevant to observe that the rapid increases in time deposits since early 1960 and the extraordinarily rapid increases early this year had no noticeable effect in strengthening the economic situation.

Since liquid assets, although not identical in their impact upon the economy with money, are a significant variable that the Government, through debt management policy, does influence, it is useful to observe that on a liquid asset criterion also, Government financial policy has been restrictive. The ratio of money supply plus liquid assets to current gross national product now is lower than it was earlier in the decade, and the ratio if computed against full employment gross national product would be lower still.

In short, on any reasonable criterion, the Federal Reserve, exercising the Government's power to regulate the Nation's money supply, has done so in a manner that discouraged full employment, if it did not make it impossible.

DEBT MANAGEMENT POLICY AND FEDERAL RESERVE "NUDGING"

A great deal of publicity has been given to Federal Reserve open-market purchases of Government securities other than short-term as a force for reducing long-term interest rates and contributing to economic expansion. In truth, an effective policy of reducing the volume of long-term Government securities in the hands of the public