

supply is contracted, at least in the short run, for interest rates to go up, and vice versa, although the conspicuous exception from this situation in the late twenties or early thirties certainly dramatizes how deceptive the relationship can be.

Is this a generally correct observation?

Mr. RITTER. I would agree with that. In other words, the money supply has a great deal to do with what interest rates are. When the money supply is reduced, there is a good chance we will get higher interest rates and when the money supply is increased, there is a good chance we will get lower interest rates. Money supply and interest rates are pretty closely intertwined. There are other things, however, that also help to determine interest rates.

Senator PROXMIRE. As professors of money and banking, I suggest that you can make a marvelous contribution to this whole subject by trying to work out some way in which this can be made clear and simple and understandable to the public. The trouble with economics is that so much of it seems to be complex and hard to understand.

Mr. CULBERTSON. On that point I would like to observe that the relationship between money supply as a causal agent and interest rates seems to be a good deal looser than is commonly assumed.

In the postwar experience you will note that the most extreme departure in money behavior was the reduction of money supply from mid-1959 through mid-1960. This did not produce any apparent aberration in the behavior of interest rates. The interest rates continued to go up for half a year until the economy hit a peak and then went down for half a year as we went into a recession.

If a departure of money behavior of that amplitude doesn't produce a marked change in the interest rate, the short-run direct effect of money supply changes on interest rates must be much less than is commonly supposed.

Senator PROXMIRE. I take it that none of you gentlemen differ from Mr. Sprinkel's support of Dr. Friedman's suggestion that we should have a regular increment in the money supply whether it be 3 or 4 or 5 percent to correspond roughly with the growth of our gross national product and then let the free forces of the market determine interest rates.

This provides an automatic stabilizer which seems to me most attractive because then you would get it out of the political realm and out of the realm of the self-interest of bankers who may have a special interest in keeping the money supply small.

It would seem to me that this is a very attractive method of proceeding because you do have a situation which under these circumstances would permit interest rates to rise when they should rise, that is, when the economy is expanding too rapidly; and conversely they would drop when they should drop, when there is less demand for funds and you need a little stimulation for the economy.

Mr. CULBERTSON. I don't think that we will all go along with Professor Friedman's formula. I think he can make an effective case when he says, "With my rule you should have done better in the past than you have done."

Senator PROXMIRE. Let me interrupt to say that he also has a very interesting reason for this, and that is a lag between the decision on monetary action and its effect, a lag which goes from 18 to 22 months.