The most used measure of monetary policy in economic theory is the money supply, defined in the medium-of-exchange sense as private demand deposits and currency. An interpretation of monetary policy in terms of this measure also is at variance with that underlying the administration's economic program. Monetary policy also has been erratic and sometimes mischievous in the past. However, on the face of things it seems to have been a major determinant of economic developments. Unlike the case of fiscal policy, there are no major changes in the rate of growth of the money supply not followed by consistent changes in GNP.

What is the recent role of monetary policy thus measured? For a year beginning in the late spring of 1965, monetary policy was extraordinarily expansive, providing an annual rate of growth of the money supply of over 6 percent. This presumably contributes to explaining the excessive rate of growth of total demand during this period. Then in April 1966 monetary policy changed with characteristic abruptness and began reducing the money supply slightly, in comparison with an earlier average performance of growth in money supply at an annual rate of 3 or 4 percent. This can be interpreted as the factor that halted the inflationary boom, despite expansive fiscal policy, and brought the economy currently to the brink of recession.

A crucially important practical implication of this interpretation is that monetary policy remains severely restrictive. The money supply recently has shown no increase, remaining smaller than in April 1966. The monetary policy that brought the economy to the brink of recession remains in effect. It seems reasonable to believe that if continued, it will suffice to push us over the brink, to cause a recession by summer.

The Council's interpretation is that an easing of monetary policy is evidenced by recent declines in interest rates. But an obvious alternative explanation of these reductions in interest rates is that they reflect a reduction in the demand for credit associated with slackened growth of total demand and speculation on an imminent recession. The decline in interest rates, thus, may reflect the indirect effects of restrictive monetary policy rather than the direct effects of an expansive monetary policy. To settle this factual question, we must refer to a direct measure of monetary policy. Since the money supply has not increased, the reductions in interest rates cannot be attributed to monetary policy.

The Council makes its prescription for interest rates the centerpiece of its policy planning. It wants lower interest rates. But if its interpretation of the relation between interest rates and monetary policy is fundamentally inadequate, this may be a hazardous program. Doubtless, the Federal Reserve can get further reduction in interest rates by failing to provide normal growth in the money supply and causing a recession, which will cut demand for credit. But on the other hand, if the Federal Reserve jumps back in the other direction and begins providing bank reserves rapidly in an effort to give the administration the interest rates it wants, this may lead to accelerated growth in total demand and cause a rise in interest rates, which is what resulted from the rapid money growth beginning in the spring of 1965. But continued pumping of money into the economy in an effort to meet the Council's interest rate target in this environment could