affected by economic conditions and thus by monetary and fiscal policies, is insufficiently taken into account.

With reference to the two recent big changes in monetary policy, the predominant response of interest rates was the opposite of the one envisioned in the Council's interpretation. Almost simultaneously with the acceleration of growth in the money supply in late spring of 1965, the interest rates began rising. Following the abrupt shift from rapid monetary expansion to slight monetary contraction in late spring of 1966, interest rates after a few months began declining. If interest rates thus are not simply the shadow of monetary policy but reflect changing economic conditions, it appears that our limited existing knowledge may not permit us to define in a mercurial economy what is the appropriate level of interest rates at any particular time. This, of course, is by no means a new idea. Discussions of the hazard of using monetary policy to try to set interest rates run far back in the literature of economics.

This literature warns us that if an attempt is made to bring about through monetary policy any interest rate other than the unknowable one that is consistent with economic stability, the likely result is a self-feeding instability. Suppose, for example, that in responding to the Administration's call for lower interest rates the Federal Reserve now began providing bank reserves at a rapid rate, leading to a sharp increase in the money supply as in the spring of 1965. And suppose that, as seems to have happened that time, this rather quickly altered the economic situation, leading to increased demand for funds and *rising* interest rates. But so long as the Federal Reserve persisted, the more inflationary the situation became and the more interest rates rose the more rapidly it would feed in bank reserves in an effort to hold them down. Evidently such a program could lead to another period of seriously excessive growth of total demand, which in the present situation would be dangerous.

But, on the other hand, suppose that the Federal Reserve chose to maintain an interest rate that was too high for the economy rather than too low. An effort to hold up interest rates in order to limit capital outflow and protect the balance of payments could lead to this, especially if a recession is permitted to get under way. Then in an effort to hold up interest rates the Federal Reserve fails to provide normal growth in bank reserves, which weakens the economic situation and demand for funds, tending to reduce interest rates further and cause the Federal Reserve to pull out bank reserves. Evidently this process also can go on and on, and presents no happier a prospect than its opposite.

It is appropriate to emphasize these possible cases. For the erratic nature of past monetary policy, which seems to have been a major cause of economic instability, evidently arises from the Federal Reserve's attempt to bring about credit conditions, or bank reserve positions, or interest rates—these all being closely related—that it adjudges to be the proper ones. This has led to abrupt changes in the behavior of the money supply and to persistence in destabilizing actions. At present, these illustrative cases are all too relevant. Although I follow its actions rather closely, I cannot pretend to know which way the Federal Reserve will jump next. It seems to me possible either that it will continue to defend interest rates that are too high and persist in its contractive monetary policy or that it will abruptly swing back to the opposite extreme and again cause excessive monetary expansion.

A critic of this line of argument may protest that other nations seem to have a politically determined interest-rate policy without this resulting in cumulatively destabilizing policies such as we have described. If they can do it, why cannot we? The explanation seems to be that in most other countries total demand and credit conditions are more heavily influenced by international transactions than is true of the United States and that they do not have the free and integrated network of credit markets that presently characterize our economy. More compartmentalized credit markets and extensive limitations on access to credit related to government policy are common elsewhere. Interest-rate policy in such an environment can be limited to certain markets and can be largely effectuated by variations in access to credit markets rather than variations in the rate of money creation. If, for example, interest rates can be reduced by denying access to the market of some potential borrowers, this does not lead to economic expansion as would pumping newly created money into the systems. Such regulated credit markets may have serious disadvantages as a means of allocating credit, but they do permit a politically determined interest rate to be achieved without cumulative instability.

One possible implication of this line of thought, of course, is that if we want to have a politically determined interest rate—or interest rates manipulated in