

response to balance of payments considerations—we should begin to set up similar controls over credit markets. Indeed, some recent Federal Reserve actions can be interpreted as moves in that direction. For myself, I fear that the long-run costs of this approach in loss of flexibility and dynamism of the economy may involve a very high price to pay for the doubtful privilege of having an “interest-rate policy.” When other nations in recognition of the superior performance record of the United States economy are trying to move from closed towards open systems, it seems that we should think searchingly about the matter before moving in the opposite direction.

So far as large variations in interest rates such as the recent period of restricted credit availability involve social costs, evidently one approach to limiting these is simply not to cause the economic fluctuations that give rise to them. In this case, the extreme credit tightness reflected the period of extremely expansive monetary policy that created a very bullish economic climate coupled with the unusually large Treasury borrowing needs associated with the extremely expansive fiscal policy, aggravated by the abrupt shift to restrictive monetary policy. If stabilization policies were more closely controlled and less erratic, it is not clear that there would be any problem of instability of interest rates.

The principal conclusions of this interpretation in terms of immediate policy problems seem to be two: (1) Monetary policy has not eased but remains restrictive, and if persisted in seems likely to cause a recession. (2) The proposed orientation of policy towards maintenance through Federal Reserve action of a politically determined interest rate is most hazardous.

The policy actions that in my judgment are most appropriate in the present situation are prompt resumption of moderate monetary expansion at a rate of 2 to 4 per cent a year—perhaps with a faster rate very briefly to assure against onset of recession—and a tax increase if required to offset further increases in government expenditures and keep the fiscal position from shifting to an even more extraordinarily large high-employment deficit. As the economic situation becomes more normal, it would seem appropriate to move the fiscal position of the government back to a more usual one, which may be taken care of sufficiently quickly by revenue growth if government expenditures level off.

This Committee also must be concerned in broader terms with the performance of the machinery that was set up to effectuate the Employment Act. The straightforward application made here of conventional measures of fiscal and monetary policy argues that the use of these policies in the postwar period has been very erratic and that they have been a major contributor to economic instability. Presumably the reason why this has not been recognized is that great influence has attached to the descriptions of policy and the interpretations of economic events by the agencies that made the policy, as reflected in the Annual Report of the Council of Economic Advisers and the publications of the Federal Reserve System. These seem to have chosen their measures of policy and their time comparisons in such a way as to hide the defects of past policy.

Of course, it is only to be expected that the makers of policy will present it in the most favorable possible light. The question to be raised is not one of men but of systems. In its early days, questions were raised as to the desirability of the Council being at once an integral part of the Administration team and a major public interpreter of economic developments. If it is unduly influential, the biased interpretation to which this system necessarily gives rise may create an unrealistic optimism, prevent our learning the true lessons of experience, and make us vulnerable to a cumulating difficulty if our illusory world is challenged and begins to collapse. The point is one fully recognized in other areas. We should immediately see the hazard of letting thought on our international relations be dominated by a current history written by the State Department with a view to supporting and justifying Administration policies. Illusions regarding economic policy are no less hazardous than other kinds of illusions. I suggest that this general issue merits some thought in the light of recent experience.

A basic lesson to be learned from recent experience, I suggest, is that monetary and fiscal policies under existing institutional arrangements are simply not under effective control. A basic reason for this is the lack of established measures of what these policies are, which would permit them to be objectively appraised and challenges issued when they contribute to economic instability. It appeared for a time that the Council had made a contribution in this connection in proposing that fiscal policy be measured by the high-employment surplus and making this concept the center of its discussion in some years. But in other years this concept dropped out of the picture. It is difficult to avoid inferring that this happens when the concept is embarrassing to the story that the Administration wishes to tell, as surely is the case this year.