

our monetary policy that rates here will not give rise to the wrong kinds of flows out of or into the country. A money supply target in that case is inferior to interest rate target.

Fourth, the consequence of a stable money growth rate will be highly unstable interest rates. The need for money in the economy varies from day to day. There are payment dates, dividend payments, tax payments, and wage payments. On those days, a larger amount of money is needed than on others. This is automatically accommodated by the Federal Reserve with its existing procedures. By maintaining a reasonably stable interest rate, by maintaining stable-free reserves, they, in effect, vary the money supply to accommodate daily, weekly, monthly, quarterly, varying demands.

If we go on a strict money supply rule from week to week, month to month, we will certainly have great instability of interest rates. If we go on a quarterly rule as Representative Ruess suggests, instability will be less, but not much. If the Federal Reserve, for instance, were to accommodate the Treasury for 2 months, and thereby greatly to increase the money supply during the 2 months, and then were compelled in the third month to get the money supply down on target, it might create a serious squeeze.

Instability of interest rates is not a great tragedy. It is bad for the central bank, it is bad for participants of the money market. It hurts the real economy only to the extent that this instability is transmitted to it. It will be transmitted in some small degree. The main effect, I think, would be that interest rates on the average would be a little higher than they are.

If rates fluctuated widely, everybody who deals in money will have to charge a risk premium to protect himself against these fluctuations. He will charge that into the interest rate. The average interest rate will be a little higher thanks to the money target and its interest rate instability.

Fifth, the rule requires some definition of money. It makes a difference whether we use time deposits or whether we do not. We know that time deposits have gyrated widely in recent years. If the theory says that that makes no difference, then all one can say is that it is a pretty rough and ready theory.

Next, the relationship of money and income which is postulated by the growth rule is not very clearly spelled out. The theory says that the rate of growth in money is related to the level of activity. It is not obvious why something that slows the rate of growth, but leaving that rate of growth positive, should lead to a positive down turn in economic activity. You would expect a relationship that relates either levels of money with levels of income, or rates of growth of money with rates of growth of income. The reason why this peculiar relationship was chosen is mostly a statistical one; one would not get the lead-lag relationship that has been discovered unless one made that assumption.

Likewise, the mechanics by which changes and money affect changes in income are not very clearly known. I defer here to Professor Modigliani. Maybe he knows, but I do not. We know some parts of the mechanism, but we know that this mechanism works unstably. It is a mild effect, that money exerts on economic activity; it is by no means true that money has economic activity on a tight string and can pull it this