

way or that. To say that by changing money we can really control the economy is a vast exaggeration.

We are also uncertain about what is the proper rate of growth in money. Is it the rate of growth of the economy? There are findings that money, including time deposits, needs to rise almost twice as fast as economic activity. That is Professor Friedman's finding. Other findings say that, as transactions get larger, there are economies of scale in the use of cash balances. Bigger transactors can get by with a proportionately smaller cash balance. If that were true, money should grow less rapidly than income. It makes a great deal of difference which theory is right.

One piece of evidence that also makes a great deal of difference is the postwar period. Had we raised the money supply since 1946 at the rate of growth of the economy, we would have had a much bigger inflation than we have had. We had inflation even though money grew less rapidly than income. I will grant that this example is mildly biased, because we entered into the postwar period with an excessive money supply and had to grow into it. Still, that money supply was needed to have the low interest rates of that time. Had we tried to maintain those low interest rates by generating more and more money, we would indeed, I think, have had a horrible inflation.

Next, there is the lag question. It is argued that we need a fixed rule because the lags with which monetary policy affects income are so long and so unstable that it is better not to work on a discretionary basis. We might just get the full effects of a policy at a time when it was no longer appropriate. That experience is derived largely from small changes which, indeed, operate probably with a substantial lag. If you look at times when the Federal Reserve really tried to exert a drastic influence, such as in 1967, you will see that they can turn the economy around within a matter of 6 months or so. I would not recommend that as a steady diet, but the lag, in case of drastic action, is relatively short, subject to the qualifications Professor Modigliani introduced about high backlogs of orders.

Now, to wind up, let us suppose we did go on a fixed money growth rule. I would deplore this. I think the rule would get us into unexpected situations from which not the rule, but only skillful discretionary action could extricate us. For instance, if we do not accept a flexible exchange rate but continue with a stable dollar, paying out gold when we have a deficit, the rule might very well produce low interest rates at a time of economic slack. Money then flows out of the country, gold follows. And we find ourselves confronted with an exchange crisis. Now, we are asked to believe that in that crisis, the Federal Reserve will happily go on grinding out money at 4 percent or 6 percent per year.

We know that that would not stop the crisis. What they will have to do is to put up the discount rate and cut the rate of growth of the money supply. It is like saying that driving along the middle of the road we shall be safest. Well, that is true so long as all goes well. Suppose for some reason, nevertheless, the car veers off and one wheel goes over the ditch. We have made a rule never to jerk the wheel. We turn it only very slowly. Are we going to abide by that rule in that situation?