

part, by the actual policies pursued. They are never the conditions that would have prevailed had policy been guided by a fixed money growth rule. But if the money growth rule, under certain circumstances, destabilizes the economy, then the proper test for it would be how it performs in correcting a disequilibrium of its own making. To such a disequilibrium, a discretionary policy could react flexibly. The fixed rule can respond only by doing more of the same. For a while, at least, that may increase the disequilibrium.

For example, if a fixed rule should lead to inadequate growth of the money supply, as it might have in 1967, and cause or contribute to a recession, nothing can be done under the rule to turn the economy around quickly. The same would be true in case of an inflation, or of a balance of payments deficit. Conceivably, very extreme conditions might develop before the economy returns to equilibrium. Discretionary policy, whatever its defects, usually has succeeded in preventing the occurrence of such extreme conditions, with a few lamentable exceptions. Thus a comparison of a rule and an actual policy, employing the actual historical record, gives the rule the wholly unjustified advantage of always starting from a situation that discretionary policy has kept from going to an extreme. Put in simplest terms, a rule could get us into a big mess, yet the tests rarely confront the rule with such a mess.

10. Will the Rule Be Sustained?

No Congress, no President can bind a successor. Short of being anchored in the Constitution, any money growth rule can be altered or dropped. What are the chances that a rule, whether simple or complex, whether enacted into law or adopted voluntarily by the Federal Reserve, will be broken?

I believe the chances are excellent the first time the rule deviates substantially from what discretionary policy would counsel. In a recession, when the Federal Reserve would be inclined to generate liquidity rapidly, would the Congress, the public, and the Federal Reserve itself be satisfied with money being pumped out slowly? In an inflation, when money growth should be slowed sharply, would we be satisfied to see the Federal Reserve continuing to feed the process? In a balance of payments crisis, would we sacrifice a large volume of reserves instead of adopting the monetary policy that would stop the drain? In simplest terms, if the car is going off the road and one wheel is over the ditch, will we keep turning slowly because we have made a rule never to jerk the wheel?

In addition to the prospect of major breaches, there is the probability that minor adjustments in the rule will be demanded from time to time, unless the rule is very broadly defined. Evolving circumstances will show that any single percentage growth rate, or narrow range, is not the right one. If the range is wide, and if full discretion is given to the Federal Reserve within that range, the policy will not differ greatly from a discretionary one. In the end therefore, even if a rule were adopted, discretion probably would be reestablished soon in one way or another. I would regard that outcome as fortunate.

(Additional material, submitted as part of Professor Wallich's prepared statement, follows:)