

On the second issue, there is widespread agreement that interest rates play a key role. That being so, it is not clear why one should look at money as a policy target rather than at interest rates directly. A direct or real balance effect is sometimes postulated, going from the money market to the goods market and bypassing the bond market. That effect seems a priori implausible for households, however. It is hard to believe that households first allocate income to consumption and saving, respectively, and then, finding that their saving has increased their liquidity, revise the original saving decision. Only the allocation of saving to different forms of investment provides an opportunity for a real balance effect, but household investment has little direct impact on demand for goods and services except through housing. The a priori view that household liquidity does not greatly affect consumption is supported by empirical findings.³

A real balance effect is more plausible in the case of firms. A firm's decision to save requires subsequent allocation of savings to assets, most of which are real rather than financial. Empirical work has found what amounts to a real balance effect, running from business cash flows to business investment.⁴

An empirical finding whose theoretical bases remain to be specified is the tendency of changes in the rate of growth of money to lead changes in the level of economic activity. Should this phenomenon turn out to be not simply a consequence of the relation between the levels of money stock and economic activity, it would be a highly interesting and somewhat ominous affair. If the rate of money growth could never fall without danger of recession, a policy of constant or rising money growth would be required to assure full employment, and the outlook for price stability would be dim. The chances are that the phenomenon is simply a reflection of a close though not perfect correlation between levels of money and income. Declines in the rate of growth both of money and of income must then inevitably precede a downturn of income.

³ Daniel B. Suits, "The Determinants of Consumer Expenditures: A Review of Present Knowledge," in *Impacts of Monetary Policy*, Commission on Money and Credit, Prentice-Hall, Englewood Cliffs, N.J., 1963, p. 43.

⁴ Edwin Kuh and John R. Meyer, "Investment, Liquidity, and Monetary Policy," in *Impacts of Monetary Policy*, Commission on Money and Credit, Prentice-Hall, Englewood Cliffs, N.J., 1963, p. 381.