

rate in 1965, December, was very ill-received. They acted too late, not too early, as many of us said at that time.

In 1967, their reason——

Senator PROXMIRE. All of us could have been wrong in 1965. I think I was one of those who criticized them. I think I was wrong. In hindsight, though, I say reflecting on what would have been the best policy over the past several years, it might have been better if they had had the guideline.

Mr. WALLICH. We would have been better off had not a stable rule gotten us into this ditch before. I think this is very likely.

Now, 1967 is a case in point. The demand for money changed. After many years in which corporate treasurers were proud of not having a cent too much nor uninvested, it became fashionable in 1967 to have money for 5 years to spare. They all rushed out and borrowed. This demand for money could not have been accommodated by the rule. Had the rule been followed in 1967, I feel fairly confident that the mini-recession would have become a normal recession.

Mr. MODIGLIANI. I would like to really indicate full agreement with Mr. Wallich on his explanation of the three episodes; 1962 is within the period to which I referred in my testimony when I spoke of the conflict of goals between the balance of payment and domestic employment and how the Federal Reserve had chosen the balance of payments. The explanation in fact for that behavior is visible from the very same chart you have, if you will turn to the chart which gives the bond yields and interest rates. You will observe that in 1962, despite the fact that money supply was not rising, interest rates were stable or flexing. If you will look particularly at the treasury bill rate, it was in fact quite stable and some of the other rates were rather flexing. And the balance-of-payments situation essentially as interpreted by the Federal Reserve required that short-term interest rates preferably rise, but certainly should not fall. Now, you see, if you have a stable pattern or a slightly declining pattern with a constant money supply, you can see you would have declining short-term interest rates with an expansive monetary policy. They just did not feel it was appropriate. I think it is quite clear that during the period of the 1960's, until the tax cut, the Federal Reserve Bank was concerned that the short-term rate would not decline, and should move up whenever possible. So as the demand expanded, they used part of the pressure to raise rates. This is the type of situation to which I referred earlier where it would have been helpful if the conflict between goals would had come out in the open that we could not, relying just on monetary policy both maintain the dollar as the reserve currency of the world by avoiding a balance-of-payments crisis, and pursue the goal of high-level employment. The conflict might have been partly resolved only through an expansionary fiscal policy. I think the administration was in favor of a tax cut earlier and I think Congress delayed in passing a tax cut. It took the death of the President to get through a tax cut. If we had acted quickly, we would have been able to have a more rapidly expanding money supply, without risking a deterioration in the balance of payments.

As for 1966, I think on the whole, the tight policy of 1966 was exactly what was required under the circumstances. And the rapid expansion of 1967, I completely agree with Professor Wallich, was a