At the outset we have to admit that we cannot hold the Federal Reserve responsible for everything that happens in the economy. In the first place, there are other actors on the scene, and the Federal Reserve cannot accurately forecast what they will all do. In the second place, the effects of Federal Reserve policy are not all felt immediately; they are spread out over a period of variable length, but at least several months. These two facts mean that the Federal Reserve often cannot know what is the proper action to take today, in order to offset some disturbance that will happen next week and whose effects will be felt next month or next quarter.

But even granted perfect prediction, we could not hold the Federal Reserve responsible for everything, for there are times when a choice must be made between two conflicting aims, and even the Federal Reserve cannot have both.

For example, suppose—not unrealistically—that the Treasury, acting under instructions from the Congress, undertakes a large increase in spending, and that the Congress does not increase tax rates—when I wrote this, the Congress didn't look as though it was going to increase tax rates and I am very pleased that it now looks as though this may happen.

The obvious result would be a large increase in the budget deficit, if there were an increase in expenditure with no increase in tax rates. The Treasury would have to finance this deficit by offering new U.S. Government securities for sale. What will happen? Consider two possibilities.

First, the Federal Reserve could assist in the financing by buying and holding whatever portion of the new securities is not taken up by private investors. In that case, the stock of money would increase, because part of the money that the Treasury spends would be created when the Federal Reserve buys new Treasury securities.

Or, take the second possibility, the Federal Reserve could decline to assist in the financing; that is, buy none of the new Treasury securities offered. In that case, the Treasury would have to offer better terms to the private market; that is, higher interest rates, in order to induce the private market to buy all the securities offered. Then the stock of money would not increase, but interest rates would increase.

Thus, the Federal Reserve has a choice, when faced with a Treasury deficit; the Federal Reserve can increase the money stock while maintaining interest rates about the same, or hold the money stock fixed while permitting interest rates to go up. Of course, one could imagine a policy somewhere between these two, permitting some increases in both the money stock and in interest rates. But the Federal Reserve cannot stabilize both the money stock and interest rates in this situation when there is a large deficit.

Similarly, when faced with a Treasury surplus, the Federal Reserve has a choice between stabilizing the money stock while interest rates fall, or stabilizing interest rates while the money stock falls, but cannot stabilize both.

It is pretty clear that the Federal Reserve can control the stock of money within narrow limits. I mean they can make the stock of money come within plus or minus one-half percent of any desired level, 99 weeks out of 100.

By the way, the money stock concept I am using is the Federal Reserve's own: currency and demand deposits.