

It is certain that a policy of increasing the money stock at 4 percent a year, or between 3 and 5 percent a year, would not be the best possible Federal Reserve policy, if we knew everything about how the economy operates. But we don't know that, and therefore, we don't know what the best possible policy is.

I would like to argue *first* that, given our present knowledge, we will probably have better monetary policy if the Federal Reserve sees to it that, during every calendar quarter, the increase of the money stock is at a seasonally adjusted annual rate of between 2 and 6 percent, better I mean than we would have if the Federal Reserve follows policies like those of the past. I would like to argue *second* that the Federal Reserve ought not to change this rate of change abruptly, from a 2-percent annual rate in one quarter to a 6-percent annual rate in the next quarter, or vice versa. *Third*, it is more important to stabilize the rate of growth of the money supply than to stabilize interest rates, whenever the Federal Reserve must make a choice.

For the long run, a 4-percent annual growth rate in the stock of money is about right. Real GNP has been growing at 3.9 percent a year since 1948—when one might say the economy had returned to normal after World War II. At roughly constant interest rates, which we have not had within the last 20 years, a roughly constant price level, the demand for money grows roughly in proportion to real GNP. If the money stock grows much *faster* than 4 percent a year, say 8 percent or more, then aggregate demand is induced to grow much faster than capacity. When demand catches up and overtakes capacity, there is upward pressure on the price level. If the money stock grows much *slower* than 4 percent a year, say it doesn't grow at all, or even declines, then aggregate demand is induced to fall rapidly behind capacity. When this happens, we have deflation, downward pressure on prices, and unemployment.

During 1941-45, the money stock grew at 22 percent a year; everyone agrees that this was far too fast for stability. During the depressions of 1921 and 1929-33, and all the recessions since 1921—they were in 1924, 1927, 1938, 1949, 1954, 1958, and 1961—the money stock *actually declined in absolute terms*, which in my opinion should not be permitted.

I think that is a very important criticism of Federal Reserve policy in the past, that they have permitted the stock of money to decline during depressions.

The evidence so far is not persuasive in favor of the claim that small variations in the rate of growth of the money supply cause business cycles. But it is clear that an actual decline in the money stock, or a prolonged period of little or no growth, aggravates any recession that is in progress or that might develop. Similarly, a prolonged period of rapid growth in the money stock aggravates any overheating that is in progress or that might develop.

Furthermore, rapid changes in the rate of growth of money stock are themselves a disturbing factor.

That is why I would like to see the Federal Reserve keep the rate of growth of the money stock fairly steady, between 2 and 6 percent a year, and to vary this rate of growth only gradually.

It should be pointed out that if the Congress were to require the Federal Reserve to follow any such rule, the Congress would thereby