

of a problem in most other countries than it is in the U.S. Expansive or contractive monetary policy actions can be induced by budget deficits or surpluses where F.R. acts to prevent interest rates from changing as much as they otherwise would. The test of whether the F.R. has added to the inflationary or deflationary impulse of fiscal policy is not whether interest rates went up or down but whether the F.R. sold or bought securities or took equivalent actions with its other policy instruments. It is typical, though not necessary, for rising budget surpluses such as in 1959 to induce deflationary F.R. policy actions and for budget deficits such as 1967 and 1968 to induce inflationary F.R. actions.

Central bankers the world over share the F.R.'s misconception of the proper measure of the stance of their policy actions.¹³ This misconception is particularly dangerous when the level of total demand is at a peak and begins to decline. In this situation it is natural for interest rates to decline and money market conditions to ease in the absence of any F.R. policy actions. The danger is that the F.R. may be fooled into interpreting declines in interest rates as a sign of expansionary policy despite the fact that it takes actions to prevent interest rates from falling as far or fast as they would if there had been no policy actions. Similarly during inflationary periods rising interest rates can lead the F.R. to misinterpret its policy stance.

Earlier I mentioned the analogy of this policy to a baseball player who can't hit a curve. That analogy can be extended to include the policy of moderating variation in rates of monetary growth. It's a natural curve ball hitter just as the F.R. policy is a natural strike-out. Moderating variation in monetary growth—on the basis of the kind of curves the economy has offered in the postwar period—would automatically tend to damp the worst excesses of induced monetary policy reaction to the economy. Fifty-five years of swinging at where the economy was, not where it is, would seem a fair chance for the central bankers' policy. It may be time to substitute a new policy—particularly when one considers the ominous prospects our economy faces today because of policies in the recent past.

Chairman PROXMIRE. Our final witness is Prof. Richard Selden, of Cornell. Professor Selden?

**STATEMENT OF RICHARD D. SELDEN, PROFESSOR OF ECONOMICS,
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Mr. SELDEN. I appreciate very much having an opportunity to participate in this important discussion of the role of guidelines in governing Federal Reserve policy.

My statement this morning consists first of some general observations about guidelines, and then some more specific comments about the proposal of Representative Reuss which appeared in the committee's 1968 report.

The quest for monetary guidelines goes back at least to the famous controversy of the 1940's in England between the currency school and the banking school. In the 1920's in this country, there was lively discussion of proposals to direct the Federal Reserve to attempt to stabilize an index of commodity prices. In 1936 Prof. Henry Simons published an article titled "Rules versus Authorities in Monetary Policy" in which, after surveying a variety of monetary rules, he concluded that the selection of a particular guideline, such as stabilization of the price level or of the volume of money, was less important than acceptance of the principle that some rule should be adopted and announced to the public.

Simons saw three main advantages to the adoption of a monetary rule. First, it would tend to stabilize business expectations. According

¹³ William G. Dewald, "Indicators of Monetary Policy," *Economic Papers*, "The Economic Society of Australia and New Zealand, New South Wales and Victorian Branches" (August 1967), 16-43.