

to Simons, the major source of the uncertainties that plague business planning and lead to fluctuations in investment spending is government itself—and especially the monetary authority. The announcement of a simple rule that would be adhered to steadfastly would create a stable environment within which rational decisionmaking could proceed with comparative calm. Second, Simons was disturbed by the antidemocratic implications of vesting great power in the hands of a quasi-independent agency such as the Federal Reserve Board. Congress, he felt, should retain closer control over this important area. However, the only feasible way of establishing firm congressional control over money would be for it to lay down guidelines within which the Federal Reserve would have to operate. Third, adherence to a rule would prevent the monetary authority from following perverse policies. The case that usually is cited is the 1929–32 period when the volume of money fell by about 25 percent during one of the most severe business contractions the country has ever known. It is generally agreed that a policy of maintaining a constant money stock—assuming this could have been achieved, and I have no doubt at all that it could have been—would have been far preferable to the one actually followed by the Federal Reserve, and it is plausible to suppose that instead of suffering through a great depression the economy would have experienced something more closely resembling our mild postwar recessions after 1929. This point of view received empirical support from the work of Dr. Clark Warburton, former chief economist for the Federal Deposit Insurance Corporation, who found that every business cycle peak during the interwar period was preceded by a lapse of monetary growth from its “normal” upward trend of 5 percent per year. Warburton concluded that the Federal Reserve should aim at a growth rule that would prevent such lapses—as well as inflationary excesses—in the future.

It is probably fair to say that the contemporary phase of the guidelines debate grows out of Prof. Milton Friedman’s work on lags in the effect of monetary policy, which has provided a fourth reason for adoption of a monetary rule. While by no means rejecting the arguments of Simons and Warburton, Friedman has argued that a flexible; that is, discretionary, monetary policy is likely to intensify business fluctuations rather than moderate them. The reason is that policy changes influence the economy only after very substantial time-lags. The policy initiated in May 1968 may not reach its maximum impact until, say, July 1969. But neither the Federal Reserve nor anyone else possesses dependable means of forecasting the state of the economy a year or more in advance; hence there is every likelihood that today’s policy will turn out to be inappropriate by the time it matures. And to compound difficulties, Friedman believes that monetary lags are highly variable, and unpredictably so. Hence even if we could foresee the state of the economy a year or two from now there would be no assurance that the policy changes initiated today would blossom forth precisely when intended.

Friedman’s doctrine of long and variable monetary lags has not gone unchallenged, of course. Critics have disagreed with his statistical methods and his choice of variables for timing comparisons. It has been pointed out that the effects of monetary policy are likely to be spread out over lengthy time spans and that a significant portion of the effects