

Chairman PROXMIRE. This suggestion though, it seems to me, that the money authorities have less capacity to influence rates than we might otherwise think. I notice that one of you gentlemen suggested that in the 1930's, at least in the beginning of the 1930's, we followed a perverse monetary policy, but certainly in the 1930's, the mid-1930's and on, we followed a policy of keeping interest rates so low they were almost negative. Remember short-term Federal obligations yielded very little more than zero. Mr Dewald, you apparently disagree.

Mr. DEWALD. Very strongly, yes.

Chairman PROXMIRE. Good.

Mr. DEWALD. The quantity of money fell by about 25 percent narrowly defined from 1930 through 1933. After the economy had gone through this traumatic experience, banks were afraid of their shadows, as they should have been. The public was afraid of the banks. People didn't just talk about a change in liquidity preference. You really had it in that period. People did want to hold the most liquid asset, namely Government money. In that situation the monetary authority certainly played a role in the change in liquidity preference by scaring the wits out of the banks and the public. You had very low interest rates on some kind of highly liquid instruments, not on all. The low interest rates on close substitutes for money were partly the result of a change in liquidity preference which implies an increase in interest on loans that, to lenders, aren't such close substitutes for money. Another point is that during the 1930's, the Federal Reserve asked for additional authority because of the fear of inflation. This is hard to believe, but it's true. There were a tremendous amount of excess reserves in the system, so the Federal Reserve asked for the authority, and Congress gave it to them, to double reserve requirements, to reduce the inflationary potential. That is precisely what they did, and the effect of doubling those reserve requirements, of course, was to increase interest rates in that period.

Subsequently, there was a further increase in the demand for highly liquid kinds of assets, and it was in that period, 1938-39, following this painful experience—you know recession within a recession, to which the Federal Reserve contributed—that you had these close to zero rates of interest.

Chairman PROXMIRE. Of course, we are speaking about relatively different things. It is hard to look now at 1938 or 1937 as a period of high interest rates because we are not accustomed to interest rates that are so much higher. But what I am trying to get at is it is difficult to see how the monetary authority could have done much more to stimulate the economy during the period say from 1933 on than they did. Perhaps they could, you are undoubtedly a much closer student than I, but the Martin notion of pushing a string by using monetary authority to keep their rates down and, therefore, the borrowing attractive to industry, just seemed to be quite sterile in that period.

Mr. DEWALD. The argument of pushing a string I think is just a rationalization for perverse actions. The period of the 1930's was one where monetary policy could have been very different. Let's consider this possibility. Suppose that monetary policy actions had been taken commencing in 1930, such that the quantity of money had increased at the average rate that it increased over the period of 1920's. This is really the kind of thing that we are suggesting.