knows about it. Nobody knows the reasoning. We think this might be a way of getting into it.

So I apologize for that long explanation, but I think maybe it will be helpful to you. And I want to thank you for your prepared statements.

As recipients of the impact of Federal policymaking and as respondents to the challenge of reading the future of the markets and of the intention of the Fed, I am sure you are going to give a good explanation of your viewpoints, so you go right ahead.

Our first witness, and we may as well move from left to right, as that is the usual course, is Mr. Gaines.

STATEMENT OF TILFORD C. GAINES, VICE PRESIDENT AND ECONOMIST, MANUFACTURERS HANOVER TRUST CO., NEW YORK, N.Y.

Mr. GAINES. Mr. Chairman, it is a pleasure to be here today. I will plunge right into the statement.

Chairman PROXMIRE. Fine.

Mr. GAINES. An attempt to develop more precise guidelines for Federal Reserve policy than those contained in the Federal Reserve Act and in the Employment Act of 1946 should start with an appraisal of what effects Federal Reserve policy might be expected to have and of the process through which these effects are achieved.

Many analyses have imputed to the Federal Reserve far greater power than it actually has, and have related monetary policy to the economic process through channels that are not fully relevant to the strategic areas of impact of policy.

In any given set of economic circumstances, Federal Reserve policy can have a regulating but not controlling influence upon the size and composition of credit flows, upon the level of interest rates, and upon money supply—however defined. To be effective, policy must be constrained by the need to keep financial markets functioning normally. Efforts to force credit or money growth into an arbitrary mold, without regard to the demand for credit and money that the economy is generating, could have wholly unpredictable consequences upon the ability of the financial markets to function and thereby upon economic stability.

Orderly monetary policies from one year to the next in combination with orderly fiscal policy can help to avoid extreme swings in the demand for credit and money; but when such swings do occur, responsible Federal Reserve policy can do no more than temper them.

The policies pursued by the Federal Reserve System in 1966 and 1967 offer excellent illustrations of the limits within which monetary policy can be responsibly effective.

During the summer and fall of 1966 the Fed, out of concern for the inflation spiral that had developed, attempted to do more than monetary policy is able to do. It should not be held responsible for the disintermediation from the savings institutions and the troubles for residential construction that occurred at that time. The disintermediation resulted from the existence of large, interest-sensitive deposits in many savings institutions, including commercial banks, and their withdrawal could have been prevented only by pegging market interest rates and thereby permitting unlimited credit growth.