

create some institutional problems—but no one is talking about large abrupt changes anyway. So this qualification has no practical significance.

Perhaps I should not presume to speak for them, but I have always assumed that what people meant when they say “the Federal Reserve cannot control the money supply in the short run” is that it cannot do so as a practical matter—that the result of an effort to hold the rate of expansion stable would create disorderly conditions in financial markets at unacceptably frequent intervals.

I have never been altogether comfortable when opponents of “the rule” rest their case too heavily on this argument. It is hard to prove, one way or the other—and in any event it lowers the quality of the dialog to the *reductio ad absurdum* level.

I have discovered nothing in my relatively brief experience as a commercial banker that leads me to question the proposition that, with rare exceptions, the Federal Reserve could, by its policy actions, force the commercial banking system to so manage its assets and liabilities as to produce a reasonably stable rate of growth in the narrowly defined money supply in the 3 to 5 percent annual rate range. Such a policy would only rarely produce acute financial market problems and then with ample warning so that modifications could be made.

I would go even further and say that from a narrow, self-interest point of view commercial banks would probably benefit from such a policy. It would, after a brief period, considerably simplify the problems of bank asset and liability management, especially if it were accompanied by the removal of all interest rate ceilings—as most advocates of a rule recommend.

How does the adjustment mechanism work so far as commercial banks are concerned? In fact, it appears strangely enough to work just about the way the textbooks say it should work. The initial adjustment takes the form of transfers—one way or the other—of financial assets between the banks and the nonbank public. In the first instance, the banking system adjusts to lesser reserve availability by selling securities from its portfolio to the public and thereby extinguishing demand deposits.

Of course, an individual bank may borrow, but if the Fed holds fast to its reserve target some other bank is forced to sell an asset. In reverse, banks respond to increased reserve availability by buying securities from the nonbank public and thereby increasing demand deposits.

For all practical purposes this happens so fast in either direction one can almost say that there is no lag at all—1 or 2 weeks at the most. If you really believe that money is the only thing that matters, you can stop there. The significant change has occurred when some depositor somewhere exchanges his deposit for a Treasury bill and aggregate demand deposits are reduced by an equivalent amount, or vice versa.

But most of us—and this certainly includes both bankers and Members of Congress—cannot be quite so Olympian in our attitude. The remainder of the adjustment process, and its effect on interest rates, and conditions in credit markets is a matter of serious concern.

In order not to extend this statement unduly, let me focus on bank adjustment under one assumption, rather than taking both restrictive and expansionary assumptions. The case which is of most concern