

reasons interest rates are high is because the expectation is we are going to have further inflation.

One of the reasons why the public expects further inflation is that they expect the Fed to pump so much money into the economy. So that if they adopt on a permanent basis a policy of not increasing the money supply so rapidly when we are in an inflationary period, it seems to me that this might help stem inflation, because expectation and psychological attitudes are so important in inflation itself.

Having said that, I am going to ask Representative Rumsfeld if he would like to follow on these questions. I will be back in about 5 minutes.

Representative RUMSFELD. First, I would also like to join the chairman's comment that these papers are most interesting. Possibly one or more of you might like to comment on the chairman's last statement.

Mr. GAINES. I agree completely with the proposition that Federal Reserve policy should avoid the extreme swings that have sometimes characterized it in the past. I do not think that the extreme swings, however, as they are reflected in interest rates, could be avoided just by establishing a money supply target or guideline.

On the question of interest rates, it seems to me that a good many of the financial difficulties that the country has encountered in recent years have resulted from the wide movements in interest rates.

To be specific, Federal Reserve policies in 1966, along with credit demands, resulted in market rates of interest moving above the traditional levels that our economy had had any experience with. The results of this were the dislodgement of huge amounts of relatively hot or interest sensitive money from the savings institutions and the "crunch" in the real estate market that we experienced.

Subsequently, the Federal Reserve in the first half of 1967 followed policies that resulted in interest rates that were once again well below the rates available in the savings institutions, so a lot of the hot money flowed back into them. It has since been disintermediated again at the currently prevailing high rates of interest. So long as we have savings institutions, such as savings and loan associations that are not able to adjust their own rates of return on their portfolios quickly to these swings in interest rates, it seems to me that policies that result in wide swings in interest rates that first suck hot money into the institutions and then pull it out create a dangerous kind of situation.

I believe that if a set of policies could be developed over a period of time that resulted in a relatively stable level of shorter term interest rates. Then the savings institutions would be able to operate on a sounder basis from 1 year to the next without having to be concerned about vast movements of savings money in and out.

This objective cannot be achieved simply by zeroing in on a money supply growth target. It has to be concerned with the broader flow of credit funds through the economy which is not always measured by money supply movements.

Representative RUMSFELD. Let me pose some of these questions that the chairman wants our record to include.

Take the case of 1967, when the money stock grew by 6.5 percent. What would have been the consequences of strict adherence to a rule of 5-percent maximum growth? Would the outcome have been preferable to the actual course of events?