

This revival was strongly fostered among economists by the theoretical developments initiated by Haberler but named for Pigou that pointed out a channel—namely, changes in wealth—whereby changes in the real quantity of money can affect aggregate demand even if they do not alter interest rates. These theoretical developments did not undermine Keynes' argument against the potency of orthodox monetary measures when liquidity preference is absolute since under such circumstances the usual monetary operations involve simply substituting money for other assets without changing total wealth. But they did show how changes in the quantity of money produced in other ways could affect total spending even under such circumstances. And, more fundamentally, they did undermine Keynes' key theoretical proposition, namely, that even in a world of flexible prices, a position of equilibrium at full employment might not exist. Henceforth, unemployment had again to be explained by rigidities or imperfections, not as the natural outcome of a fully operative market process.

The revival of belief in the potency of monetary policy was fostered also by a re-evaluation of the role money played from 1929 to 1933. Keynes and most other economists of the time believed that the Great Contraction in the United States occurred despite aggressive expansionary policies by the monetary authorities—that they did their best but their best was not good enough.¹ Recent studies have demonstrated that the facts are precisely the reverse: the U.S. monetary authorities followed highly deflationary policies. The quantity of money in the United States fell by one-third in the course of the contraction. And it fell not because there were no willing borrowers—not because the horse would not drink. It fell because the Federal Reserve System forced or permitted a sharp reduction in the monetary base, because it failed to exercise the responsibilities assigned to it in the Federal Reserve Act to provide liquidity to the banking system. The Great Contraction is tragic testimony to the power of monetary policy—not, as Keynes and so many of his contemporaries believed, evidence of its impotence.

In the United States the revival of belief in the potency of monetary policy was strengthened also by increasing disillusionment with fiscal policy, not so much with its potential to affect aggregate demand as with the practical and political feasibility of so using it. Expenditures turned out to respond sluggishly and with long lags to attempts to adjust them to the course of economic activity, so emphasis shifted to taxes. But here political factors entered with a vengeance to prevent prompt adjustment to presumed need, as has been so graphically illustrated in the months since I wrote the first draft of this talk. "Fine tuning" is a marvelously evocative phrase in this electronic age, but it has little resemblance to what is possible in practice—not, I might add, an unmixed evil.

It is hard to realize how radical has been the change in professional opinion on the role of money. Hardly an economist today accepts views that were the common coin some two decades ago. Let me cite a few examples.

In a talk published in 1945, E. A. Goldenweiser, then Director of the Research Division of the Federal Reserve Board, described the primary objective of monetary policy as being to "maintain the value of Government bonds. . . . This country" he wrote, "will have to adjust to a 2½ percent interest rate as the return on safe, long-time money, because the time has come when returns on pioneering capital can no longer be unlimited as they were in the past" [4, p. 117].

In a book on *Financing American Prosperity*, edited by Paul Homan and Fritz Machlup and published in 1945, Alvin Hansen devotes nine pages of text to the "savings-investment problem" without finding any need to use the words "interest rate" or any close facsimile thereto [5, pp. 218–27]. In his contribution to this volume, Fritz Machlup wrote, "Questions regarding the rate of interest, in particular regarding its variation or its stability, may not be among the most vital problems of the postwar economy, but they are certainly among the perplexing ones" [5, p. 466]. In his contribution, John H. Williams—not only professor at Harvard but also a long-time adviser to the New York Federal Reserve Bank—wrote, "I can see no prospect of revival of a general monetary control in the postwar period" [5, p. 383].

Another of the volumes dealing with postwar policy that appeared at this time, *Planning and Paying for Full Employment*, was edited by Abba P. Lerner and Frank D. Graham [6] and had contributors of all shades of professional opinion—from Henry Simons and Frank Graham to Abba Lerner and Hans Neisser. Yet Albert Halasi, in his excellent summary of the papers, was able to say,

¹In [2], I have argued that Henry Simons shared this view with Keynes, and that it accounts for the policy changes that he recommended.