

The one element common to most theories of the relationship between monetary policy and economic activity is the process of adjustment by banks. Recent evidence suggests that banks make adjustments to monetary changes quickly—within a month or two [2] [5] [7]. This type of evidence leads those who focus on credit availability to conclude that changes in monetary policy are quickly felt by bank borrowers and depositors and that income changes follow shortly thereafter.

Actions of the monetary authorities and banks produce changes in the money supply. Quantity theorists start with this change in money supply to measure what they consider the most significant part of the outside lag of monetary policy. The best-known study of this lag found that changes in income lagged changes in the quantity of money by an average of about fourteen months using one type of formulation, and by about five months using another method of comparison [3]. Other studies obtained similar results.³

Most investigators have used a change in interest rates as the starting point to measure the major component of the outside lag of monetary policy. Their estimates vary widely, but the minimum lag found has been about three months with many estimates ranging up to eighteen months and more.⁴ There is little concentration of estimates at any point in the three- to eighteen-month range, so that on the surface an estimate of almost any length within this range seems equally likely.

LAGS AND PUBLIC POLICY

Table 1 presents a range of estimates for the various components of the lags of monetary and fiscal policy suggested in the previous section. While these ranges are not all-inclusive, they do include the thinking and findings of most economists.

Table 1

RANGE OF ESTIMATES OF THE AVERAGE LAGS OF MONETARY AND FISCAL POLICY (in months)

	Inside Lags		Outside Lags	Total Lags
	Recognition Lags (1)	Action Lags (2)	(3)	(4)
Monetary Policy	3	0	1-20	4-23
Fiscal Policy	3	1-15	1-3	5-21

Table 1 suggests several conclusions which have important implications for public policy:

1. Estimates of the lags of monetary and fiscal policy differ widely.
2. Monetary and fiscal authorities are doing a relatively good job in recognizing changes in the economy.
3. Monetary authorities generally act promptly but the effects of action may take considerable time to be felt.
4. Fiscal authorities often act slowly but the effects are usually felt fairly quickly.

³ See [6] for a summary of some of these studies.

⁴ For summaries of some of these studies see [4].