

Inasmuch as changes in policy—especially monetary policy—take time to be effective, it is necessary to anticipate. Given the objective of trying to reduce fluctuations in economic activity, monetary and fiscal policy should have a stimulative effect when the economy is declining and a restraining effect when it is increasing. If outside lags are very long, a change of policy initiated at the beginning of a change in the economy may not begin to have any substantial effect until the need is past. Instead, it may have its greatest effect when the direction of the economy has reversed and the opposite policy is called for. In such case, changes in monetary and fiscal policy would aggravate fluctuations in the economy. The shorter the outside lags, the less likely is a distortion of this kind and the more effective are the policies in reducing undesired fluctuations in economic activity. Policy changes, therefore, sometimes need to be out of step with current fluctuations in the economy, coming *before* the need arises so that their effects will be felt at the appropriate time.

This puts a premium on business forecasting. Good forecasts, by “recognizing” a change before it occurs, in effect make the recognition lag negative and greatly improve the timing of monetary and fiscal policy by compensating for the other lags. If the outside or action lags are very long, good forecasting is essential for monetary and fiscal policy to be effective in helping the nation achieve its economic objectives. Even if the outside or action lags are not long, good forecasting can contribute significantly to the timeliness of policy actions.

Another way to reduce the over-all lags of monetary policy is to reduce the action lag. For fiscal policy there is considerable room for movement. Most proposals involve giving the President authority to make changes in taxes or expenditures without waiting for the full process of Congressional review and determination. There may be ways to speed up Congressional action as well.

The length of the outside lags of monetary and fiscal policy is determined by responses to policy changes of many individuals and businesses. It is not known whether or not anything can be done about this reaction time. Perhaps research will reveal possibilities of influencing the outside lags of monetary and fiscal policy by changing the types or mix of tools employed.

Some economists, convinced that the lags of monetary and fiscal policy are long, have suggested that the Government get out of the stabilization business. They advocate replacing current reliance on discretionary policies with a set of rules that would hold the monetary and fiscal environment stable rather than try to have it counter short-run fluctuations in economic activity. This would not reduce cyclical fluctuations but, it is argued, would keep them from being aggravated by well-intentioned but inappropriate Government policies.

Many economists do not go this far. They think the lags are at the short- rather than the long-end of the ranges given in Table 1 or they are confident that lags can be reduced. They see discretionary monetary and fiscal policy helping in a significant and positive way to reduce undesired fluctuations in the economy.

Much has been done toward understanding lags and in dealing with them, but much more remains. One thing is certain. Policy decisions and actions must be made and interpreted with the problem of lags clearly in mind. Policymakers and the public must look to the future if they are to obtain the conditions they desire in the present.

TECHNICAL APPENDIX—MEASUREMENT OF THE LAGS

Measurement of lags of monetary and fiscal policy is difficult. Notions of the exact nature of the lags are not completely developed and the methodological and statistical problems involved are formidable. These factors account, at least in part, for a wide divergence of opinions and estimates of the length of the lags.

Inside lags. Conceptually, measurement of the inside lags is fairly straightforward but in practice is often complicated by lack of suitable data and difficulties in interpreting available data. What is required is an indication of when those with policy responsibilities recognize changes in the economy and when they *decide* to change policy. Since these lags generally relate to unannounced judgments and intentions of policymakers, currently available time series will not do. These series may well be influenced by other factors and give a misleading impression of the length of the recognition and action lags.