

CURRENT MONETARY POLICY: A CRITICAL APPRAISAL

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I asked this question on a final exam in a Money and Banking course many years ago.

Assume that you are Chairman William McChesney Martin of the FRB. What policies do you recommend that the Fed pursue to stop a burgeoning inflation?

This was the last of a long hard series of questions and one student wrote, "I've had enough trouble with this exam without assuming I'm someone I'm not." Period! I won't tell you what grade I gave this fellow for that answer. To do so would tell you more about me than I'm sure you want to know. What you want to know, I think, is how I think the question I asked on that exam should be answered. What I think about using monetary policy to combat inflation is, in any case, the central theme of my talk.

To begin with we can have no doubt whatever that Chairman Martin is concerned right now in April, 1968 with the problem of burgeoning inflation. He said so Friday a week ago. I quote, "The nation is in the midst of the worst financial crisis since 1931." And, he continued, "In 1931 the problem was deflation, today it is inflation and equally intolerable."

Before coming to grips with the policy question of what the Fed should do to stop inflation I want to answer two preliminary questions. The first of these is whether Chairman Martin's present concern with inflation is relevant and realistic. This is a fair question for two reasons. First, and I say this with all due respect, McChesney Martin sometimes chases ghosts. I'm sure you all remember that four years ago at Columbia he saw the ghost of 1929 lurking in a dozen "disquieting similarities." The spectre he raised then didn't scare me and it shouldn't have scared anyone. It simply didn't exist. The second reason this question is a fair one is that Martin's concern with inflation is not new. Back in 1959 he told the Senate Finance Committee that the Federal Reserve is "always fighting inflation." The list of such citations could be greatly multiplied, for in the seventeen years since Martin became the ranking officer of our monetary authority—i.e., the Fed, the primary objective of U.S. monetary policy has been the avoidance of inflation. Viewed in the perspective of our monetary history in these seventeen years this concern with inflation has been excessive. Between 1951 and 1968 the CPI rose only by 28.5 per cent, and nearly half of the total rise occurred in five years, in 1956, '57 and '58 and 1966 and 1967. For the WPI the record shows the total rise was only 10 per cent between 1951 and 1968. Moreover, the record was one of complete stability except for 1956, '57 and '58 and the last two years. Clearly inflation has not always been a major problem in the seventeen years that McChesney Martin has been Chairman of the FRB. Nonetheless, particularly during the first decade of Martin's stewardship "tight-money" policies were pursued relentlessly to combat inflation and at times the costs exceeded the benefits. Because the fight against inflation, however noble, involves the risk of deflation. If carried too far, tight money policies end in recession. Since 1951 the pursuit of tight-money ended in recession three times. We suffered recessions in the wake of tight-money policies first between July, 1953 and August, 1954, second between July, 1957 and April, 1958 and third between May, 1960 and February, 1961. Add also that tight money caused what has been termed a "mini-recession" in the latter part of 1966 and first half of 1967. (Some equate tight money with high and increasing interest rates, others with little or no growth in the money stock. The recession episodes cited followed periods when money was tight whether defined in terms of interest rates or money supply.)

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