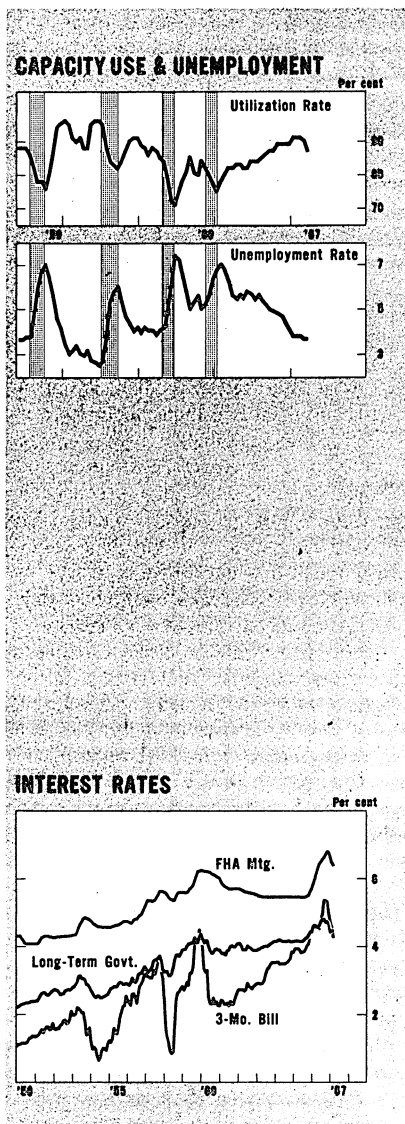




remains, and our policy goals—both domestic and international—could be jeopardized if we do not show more progress in moving toward equilibrium.

Furthermore, any pride we might take in the overall economic performance of the postwar years is diluted when we consider the amount of lost production and idle resources whether associated with short postwar recessions or longer periods of slack in resource use. The cost of recessions is high, given our pressing social needs.

To reduce further the extent and duration of these recessions, we must learn more about the underlying causes of economic fluctuations and how to forecast their occurrence. It is well known that the effects of monetary policy on the economy are not instantaneous. Since the lags are variable and sometimes substantial, poor forecasting can result in poor policy decisions. Granting that the forecasting art is still primitive, the solution, it seems to us, lies in improving the art, rather than abdicating to arbitrary rules the responsibility for stabilization policy.

One area in which improvements are needed is in the understanding of interactions between monetary policy and financial variables. Those developments we can observe—such as changes in interest rates—usually represent both the effects of policy and the public's responses to a host of other influences. Rising interest rates, for example, may stem from either restrictive monetary policies or from rising demands for credit. Moreover, interest rates are only one of the many terms in the complex equation that determines credit flows. Terms other than price, and the availability of loan funds to borrowers, can change drastically in ways that interest rates fail to indicate. But since changes in interest rates and the associated variations in prices of financial assets are the