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The Fed can effectively control the size of the money stock

It was evident that if the committee were to outline a number of guidelines for monetary actions of the Federal Reserve System, they should be within the effective control of the monetary authority. Targets have no meaning if the range of inaccuracy is too wide or if the constraints that have to be reckoned with are too numerous or too confining.

The testimony of witnesses in the recent hearings showed a large degree of agreement in speaking to these issues. The obligation of the monetary authority to keep financial markets functioning and to maintain the quality of the Federal Government's debt were recognized as constraints that, on occasion, acquired the status of priorities. In particular, as noted above, the severe burden imposed on the monetary authority by the growth of the Federal budget deficit in 1967 reduced the options of the monetary policymakers.

It was noted, moreover, that private-sector demand—and in particular corporate demand—for liquid assets to hold as protection against foreseen and unforeseen needs was not under the direct control of the monetary authority. Rather, it was indirectly influenced by the results of monetary actions and, in particular, by the interest foregone in the choice to hold demand deposits. Thus the so-called credit crunch of 1966, when the availability of credit, at any cost, was for a time sharply and embarrassingly reduced, was widely viewed as an important cause of the broad corporate policy of building up liquidity in 1967. While the acceleration of corporate tax payments was a contingency that the Federal Reserve System could provide for, on a reasonably accurate quantitative estimate, the identification of the temporary surge in demand for money—money that was intended to be kept, rather than to be spent, and thus to generate an increase in the credit flow—was not easy. Moreover, there was no assurance that this abnormal increase in the money supply would not, at some future date, be used to fuel an inflationary increase in credit.

This particular example was held up as typical of the dilemma that regularly faced the Federal Reserve System. On balance, a majority of the witnesses felt that in 1967 monetary policy had been circumspect and, in view of the fiscal limitations, as moderate as could have been devised. That feeling, however, was not shared by those who emphasized the importance and the future potential of a very large increase in the money supply.

The sole conclusion was that the choice of tempering the surge of interest rates was explainable, whether or not with approval, as an exception to a rule of stable growth of money supply and as a concession to an increase in the demand for money, despite the inflationary potential.