A CONGRESSIONAL MANDATE FOR MONETARY POLICY

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Under the Constitution, Congress is responsible for determining the monetary regime. An attempt is made in this paper to explain, from the perspective of the self-interest of Congress, the current monetary regime. The key features of the institutional arrangements that define this regime are the institutional autonomy of the Federal Reserve System and the lack of a meaningful mandate from Congress specifying guidelines for the conduct of monetary policy. Also, an attempt is made to explain how these features of the current monetary regime shape the decision-making process of the Federal Reserve System. Finally, some comments are offered on the likelihood of Congress putting into place an alternative monetary regime by establishing a meaningful mandate to guide the conduct of monetary policy.

Congress

Although constitutionally monetary policy is the responsibility of Congress, the collegial, partisan character of Congress leaves it incapable of conducting monetary policy. The conduct of monetary policy requires that decisions, often of a technical nature, be made on a recurring basis. Congressional decision making, however, requires the formation of coalitions yielding a majority in order to effect actions and is too unwieldy for the conduct of monetary policy. Congress is, nevertheless, jealous of its constitutional prerogatives and unwilling to hand over monetary policy to the Executive Branch (apart from

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wartime). The solution to the problem of how to provide for the conduct of monetary policy is to turn monetary policy over to an institutionally autonomous Federal Reserve System.

This explanation can account for the institutional autonomy of the Fed, but is too general to account for other important features of the current monetary regime, especially the absence of a meaningful congressional mandate to guide the conduct of monetary policy. A complementary hypothesis, consistent with the existence of an institutionally autonomous Fed and yielding the implication that Congress will attempt to influence monetary policy, but will exercise such attempts outside of the framework of an explicit mandate, is the scapegoat hypothesis of Ed Kane. This hypothesis is described briefly below.

The Scapegoat Hypothesis

In light of the constitutional responsibility of Congress to determine the institutional arrangements within which monetary policy is formulated, there has been surprisingly little examination of congressional attitudes toward monetary policy. The discussion in this paper makes use of two important exceptions to this lacuna in the literature, the works of Ed Kane and John Woolley. Kane advances an explanation for current institutional arrangements from the perspective of congressional self-interest that he labels the scapegoat hypothesis. In this paper, the basic assumption of the scapegoat hypothesis is accepted, but the hypothesis is developed along lines that emphasize the importance to the political system of those aspects of monetary policy that pertain to the distribution of income. The following paragraph contains a review of Kane's hypothesis.

According to Kane (1975, 1980, 1982a, 1982b, 1984), current institutional arrangements allow Congress to control monetary policy through informal pressure while still allowing Congress to dissociate itself from the, at times, unpleasant consequences of monetary policy.

> Since participation in decision-making leaves one less free after the fact to criticize mistakes, it is natural for incumbent congressmen to regard forging a formal association with current Fed decisions as a potential source of keen embarrassment. Whenever the unsatisfactory performance of the national economy has been a key election issue, incumbent congressmen have found it convenient to be able to blame everything on the "misguided" policies of an "independent" Federal Reserve System.
>
> [Kane 1975, p. 41]

> I maintain that the Fed is given just enough autonomy to serve as a plausible scapegoat for elected politicians and that this limited

> autonomy is bureaucratically desirable enough to make Fed officials work to preserve it.
>
> [Kane 1982, p. 193]

Kane has recently repackaged his ideas under the label "Fedbashing." This reexposition concentrates on explaining the apparent paradox of the coexistence of continual congressional criticism of monetary policy with persistent congressional failure to provide specific guidelines for the conduct of monetary policy:

> If a majority of both houses of Congress were to regard their institutional self-interest as better served by an alternative structure for monetary policy-making, they would be free (subject to the complication of having to override a Presidential veto) to enact this new structure. In particular, they could at any time choose either to supervise monetary policy much more closely or to surrender authority over monetary policy entirely to the Executive Branch. In repeatedly refusing to institute a clearly accountable structure (or unambiguous mandate) for monetary-policy decision making, Congress reveals its continuing preference for the Fedbashing process.
>
> [Kane 1984, p. 3]

Congressional Oversight of Monetary Policy

Any hypothesis intended to explain the institutional arrangements within which Congress has chosen to exercise its constitutional responsibility to oversee monetary policy must explain the characteristics of congressional behavior that Kane discusses. On the one hand, Congress continually criticizes monetary policy and attempts to influence it by threatening the institutional autonomy of the Fed in a variety of ways. On the other hand, Congress never issues any specific, meaningful guidelines for how monetary policy is to be conducted. This characteristic of congressional behavior is discussed in detail in Kane (1982a) and is documented in Woolley's (1984) study of the relationship between the congressional banking committees and Congress.

Congress regularly holds hearings at which it considers structural changes to limit the institutional autonomy of the Fed or to restrict the extent of Fed regulatory authority over banks. (See Table 7.1 in Woolley 1984, p. 140.) These changes have included, for example, requiring Fed submission to audits by the General Accounting Office (GAO), requiring Senate confirmation of appointments of regional Reserve Bank presidents, requiring changes in the representation on regional Reserve Bank boards of directors, and transferring the regulatory authority of the Fed over member banks and bank holding

companies to another regulatory authority.[1] The seriousness with which these attacks on the institutional autonomy of the Fed are pursued depends upon the extent to which congressmen are feeling constituent pressure from groups desiring a lower level of interest rates. Also, the congressional oversight hearings on Federal Reserve policy, originally quarterly and now semiannual, offer congressmen the opportunity to criticize monetary policy and, especially, to attack the Fed for high rates of interest. Only rarely, however, does Congress attempt to formulate specific guidelines for the conduct of monetary policy.[2]

The skeletal idea of Kane's hypothesis is that the observed congressional preference for exerting pressure on the Fed outside of the framework of a meaningful, explicit mandate to guide the conduct of monetary policy derives from the dual desires by Congress to influence monetary policy and, at the same time, to dissociate itself from the unpopular consequences of monetary policy. This skeletal idea is retained here. It is fleshed out from the perspective of a Congress aware of its ability to influence voting behavior through the redistribution of income. Current institutional arrangements are viewed as reconciling the desire of Congress to use monetary policy to influence the behavior of interest rates for redistributive purposes with the inherent difficulties of using monetary policy in this fashion. These difficulties are the merely transitory ability of monetary policy to affect the real rate of interest and the inflation that accompanies attempts to lower real rates of interest through monetary policy.

[1]Bills introduced in the 1st session of the 99th Congress are typical. A bill by Rep. Phillip Crane would authorize the GAO to audit the Fed. A resolution offered by Sen. David Pryor calls for a representative of small business or agriculture on the Board of Governors "in recognition of the fact that the monetary policy decisions of the [Fed] . . . affect the lives of small businessmen and farmers." Small businesses "create most of the jobs, and are extremely productive, yet they are constantly hammered by increases in interest rates," according to Sen. Pryor (*Bondweek* 1985, p. 3).

[2]One example occurred in 1975 when Congress attempted to instruct the Fed to lower interest rates. After numerous legislative compromises, this attempt was transformed into HCR 133, which required the Fed to set ranges for monetary and credit aggregates. This incident is discussed later in the paper. Another example occurred in summer 1982 when Congress responded to the following common argument. A large deficit will cause high rates of interest that will, in turn, abort the economic recovery in progress. In order to avoid this outcome, numerous bills were introduced in Congress with the intention of forcing the Fed to maintain an expansionary monetary policy. Many required the Fed to set explicit targets for interest rates. Rep. Fauntroy's bill, The Balanced Full Growth Act of 1983, would have required the Fed to transmit twice annually to Congress a target for GNP growth. This congressional activity soon disappeared, in part, because of the decline in rates in the summer and fall of 1982, but primarily because Democrats decided that politically it was more advantageous to blame high interest rates on the Republican administration rather than on the Fed.

Congress and Interest Rates

The concern of Congress for the redistributive aspects of monetary policy is concentrated in the attention it pays to interest rates. A review of the questions directed to the Fed chairman and of the commentary by congressmen in congressional oversight hearings renders inevitable the conclusion that for practically all members of Congress monetary policy is summarized by the behavior of interest rates.[3] The following quote illustrates how congressmen view monetary policy through the perspective of interest rates (*Nomination* 1984, p. 7):

> Sen. Sasser. Now the conduct of monetary policy is something that profoundly affects every citizen of this country. Interest rates determine the level and type of business investment and the shape of our economy for years to come. . . . Interest rates will determine whether new families will be able to buy their first home and whether American consumers can purchase new automobiles. . . . And interest rates will also determine the cost of servicing the national debt.

The following exchange also captures the prevalent attitude in Congress (*Conduct* 1982, p. 66):

> Rep. Paul. A lot of our discussion so far has been on interest rates, and there is justified reason for this, because when we go and talk to the people, everything they see and hear about is in terms of interest.
>
> Chairman Volcker. That is right.

Countless other examples could have been chosen.

The congressional innovation in 1975 of requiring the Fed to make public money supply targets did not represent any lessening of congressional concern over the behavior of interest rates. HCR 133 required monetary aggregate targeting, but emerged fundamentally as a consequence of congressional inability to agree upon a desirable interest rate target for the Fed in 1975. Woolley (1984, p. 147) comments:

> So, despite the innovation of attempting to give instructions to the Federal Reserve, and despite the monetarist tone, HCR 133 was toothless and compromised. It indicated some congressional concern about money supply growth rates, and it suggested that perhaps members were paying more attention to M1 than in the past. But

[3]Congressional attention generally focuses on nominal rates of interest, rather than on real rates. Perhaps the focus on nominal rates reflects the lack of observations on real rates. A focus on nominal rates also facilitates a masking of political pressures to lower real rates when anticipated inflation is rising.

> even in this respect, the legislation was flawed. HCR 133 explicitly permitted the Federal Reserve System to deviate from announced target ranges. Moreover, neither HCR 133 nor the process of debate preceding it produced a clear signal from Congress that it cared about monetary aggregates more than interest rates. The compromise language of HCR 133 explicitly incorporated references to interest rates. Reuss referred repeatedly to interest rates in his presentation of the compromise legislation to the House, assuring members that their earlier "language and intent" had been retained. And, of course, earlier House language and debate referred almost exclusively to interest rates. . . . Mainly, HCR 133 required the appearance of the Federal Reserve chairman at regularly scheduled hearings. This was an *opportunity* for fruitful exchange, nothing more.

Congressionally mandated targets for the money supply lack the substance necessary to serve as a benchmark for assessing the performance of the Fed. The Federal Reserve Act permits multiple targets for money and credit, permits the individual targets to be specified as a range of unspecified magnitude, and permits base drift in these targets from year to year. The Federal Reserve Act also does not require that the targets for the monetary and credit aggregates be hit. It states, "Nothing in this Act shall be interpreted to require that the objectives and plans with respect to the ranges of growth or diminution of the monetary and credit aggregates disclosed in the reports submitted under this section be achieved if the Board of Governors and the Federal Open Market Committee determine that they cannot or should not be achieved because of changing conditions" (Board 1984, p. 6). In short, nothing in the Federal Reserve Act effectively counterbalances the signals from Congress to the Fed about the importance Congress assigns to the behavior of interest rates.

Woolley also reviewed the reports on monetary policy issued by congressional committees after 1975 and finds no evidence of widespread congressional sentiment for money supply targeting. He argues that the monetarist tone of the House Banking Committee in the late 1970s "had a highly personal cause, the particular committee chairman and his staff. When the chairman and staff changed in the early 1980s, so did the content of the reports." He notes that after 1981, the reports of the Senate Banking Committee became more monetarist in tone, but that the reports of the Joint Economic Committee were never monetarist in tone. He concludes, "No matter how monetarist the Banking Committees may have become, other influential committees have been giving the Federal Reserve sharply conflicting instructions" (Woolley 1984, p. 150). Congressmen are concerned

about the behavior of interest rates. The specific contexts in which this concern is expressed indicates that concern over the behavior of interest rates is motivated to a significant degree by the consequences of changes in interest rates for the distribution of income.

Congress and the Redistribution Motive

In considering congressional attitudes toward monetary policy, it is useful to classify means of redistributing income as politically efficient and politically inefficient. Tariffs are considered here as an example of a politically efficient means of redistributing income. They concentrate high per-capita, visible benefits on a small, homogeneous group, while spreading low-per capita, hidden costs among a large, heterogeneous group. Over time, tariffs retain a consistent vote-gathering capability, so that to some degree they are always imposed, rather than being imposed only intermittently. Congressional responsibility for tariffs is made directly apparent to those who benefit from them.

Monetary policy, like tariffs, offers opportunities for redistributing income through its (transitory) effect on the real rate of interest.[4] The groups that Congress traditionally has tried to appeal to through advocacy of "low" rates of interest are the construction and home building industry, farmers, small businessmen, and the unemployed. The cost of achieving politically desirable "low" real rates of interest is inflation. "Low" rates of interest are produced by unanticipated money creation, but money creation does not increase the availability of real resources. It leads to inflation. The political benefits that derive from the redistributive aspects of monetary policy are transitory. They cannot be sustained the way the political benefits of a tariff can be sustained because a systematic monetary policy that generates lower real rates of interest is impossible. Also, the cost, inflation, is not hidden. Monetary policy is, in contrast to tariffs, a *politically inefficient means* of redistributing income.

[4]Economists may object to the assumption that Congress to a significant degree views monetary policy from the perspective of income redistribution, rather than macroeconomic stabilization, because monetary policy is an economically inefficient means of redistributing income. Economic efficiency is not a criterion of Congress, however. Consider agricultural programs as a way of redistributing income. Acreage restrictions, for example, promoted a wasteful employment of resources. In particular, they caused excessive amounts of inputs (seed, fertilizer, farm machinery, and labor) to be applied to land not included in the acreage restrictions. Farmers and consumers would have been better off if Congress had simply sent farmers a check in the mail. This latter, economically efficient means of redistributing income, however, was politically inefficient. In this case, it would have rendered visible costs that remained hidden under the scheme of acreage allotments.

The terminology "politically inefficient" should not be taken to imply that the redistributive effects of monetary policy are unimportant economically. The redistributive effects associated with monetary policy are significant, and these potential effects give rise to genuine constituent pressure on congressmen. Although the ability of monetary policy to redistribute income is transitory, the redistribution is nonetheless significant because it is not necessarily corrected. For example, an unanticipated inflationary shock that lowers unemployment transitorily can transfer real benefits to newly hired workers even if the inflation generates political pressures for a deflationary policy. When a subsequent deflationary shock occurs that increases unemployment, the previous group of newly hired workers will probably have acquired sufficient seniority to avoid being laid off and a different group of workers, in particular new entrants to the labor force, will bear the cost of unemployment. The ability of these transitory income redistributions to influence voting behavior is real and the political system must deal with the associated political pressure.

The terminology "politically inefficient" refers to the fact that the potential political benefits offered by monetary policy cannot be sustained. It also refers to the fact that congressmen cannot take credit for "low" rates of interest in a direct way because to do so would associate them with the costs of these policies. Public ignorance about the relationships between interest rates, the money supply, and inflation undoubtedly encourages political pressures for a "low" rate policy. An attempt to legislate explicitly such a monetary policy, and thus to take political credit for it directly, however, would in time render evident these relationships to the public and would render evident the costs of a "low" rate policy—inflation and perhaps credit rationing.

The distributive consequences of monetary policy give rise to pressures on the political system. The politically inefficient character of monetary policy as a means of redistributing income determines the way in which Congress accommodates these pressures. Current institutional arrangements give congressmen the freedom to advocate "low" rates of interest, or perhaps more aptly to criticize "high" rates of interest, without, at the same time, assuming responsibility for the inflation rate (or even jeopardizing their ability to criticize high inflation rates). As Kane argues, congressmen want the ability to influence monetary policy without assuming responsibility for it. These objectives are achieved by making the Fed institutionally autonomous, but by leaving that institutional autonomy subject to revocation so that the Fed remains susceptible to congressional pressures. By failing to specify a mandate to guide the conduct of mon-

etary policy, Congress leaves itself free to pressure the Fed for "low" rates of interest, without associating itself with the unpopular consequences of such a policy.[5]

It can be argued that there are simpler explanations than the one offered here for why Congress does not issue an explicit mandate to guide the conduct of monetary policy (while leaving the actual conduct of monetary policy to the Fed). It could be argued that congressmen are too unsophisticated to formulate a mandate for monetary policy. Monetary policy, however, is no more technical than many other issues with which congressmen deal, for example, pollution of the environment or disarmament. The congressional banking committees could assemble staffs with sufficient expertise to draft a meaningful mandate for monetary policy. Simply because congressmen may be ignorant of monetary theory does not mean that they are incapable of appreciating the immense importance of monetary policy or that they are incapable of calling upon the expertise that would enable them to provide guidelines for the conduct of monetary policy.

It could also be observed that Congress does not provide a meaningful mandate to guide the conduct of monetary policy because there is no consensus in society over the appropriate goals of monetary policy. This observation, however, only leads to a restatement of the hypothesis offered here for the kind of monetary regime put in place by Congress. In considering the way in which the political system deals with the lack of a consensus over monetary policy, it is important to recognize the distributional aspects, as well as the macroeconomic aspects, of monetary policy. Where social consensus breaks down is not just over the macroeconomic goals of monetary policy, but over the way in which monetary policy should respond to distributional considerations. The lack of a specific mandate to guide the conduct of monetary policy allows congressmen to be responsive to constituent pressures from particular groups without accepting responsibility for the consequences, consequences inimical to the interests of different groups. Formulation of a meaningful mandate to guide policy is rendered difficult because of the difficulty in reach-

[5]The collegial character of Congress allows it this latitude. There is an analogy between fiscal and monetary policy. Each congressman takes credit for government expenditures in his district, but no congressman takes responsibility for the overall level of government spending or for the deficit. Similarly, congressmen can take credit for particular actions to influence monetary policy without assuming responsibility for the overall consequences of monetary policy. In this respect, there is a difference between the Executive Branch and Congress. The president, as opposed to individual congressmen, is likely to be blamed for undesirable consequences of monetary policy. The Executive Branch has little to gain from scapegoating, so that it can be conjectured that it would like to have direct control over monetary policy.

ing consensus over policies that enhance the welfare of one group to the detriment of another.[6]

The relation between the difficulty of the political system in establishing a consensus in matters with significant distributional consequences and the failure of Congress to establish a mandate for monetary policy was discussed above. This discussion can be illustrated with reference to the interplay between monetary and fiscal policy in the 1960s and 1970s. Over the last two decades in the United States, there has been no satisfactory procedure for determining the share of national income allocated to the public sector. Expenditures have been decided upon for particular programs without a social consensus that the resulting total expenditure constituted an acceptable fraction of national income. In the 1960s and 1970s, inflation allowed the political system to resolve the conflict over the share of income to allocate to the public sector, without directly confronting this lack of consensus, by increasing revenue without the need for Congress to vote explicitly for new taxes. Inflation increased revenue in two ways in addition to the seigniorage of a tax on cash balances. First, unanticipated inflation provided for an effective increase in revenue through a decrease in the market value of outstanding government debt. Second, inflation increased government revenue because of the specification of the tax code in nominal, rather than real, terms. Because of the implications of monetary policy for government revenue, the absence of a social consensus over the fraction of output to assign to the public sector inhibits Congress from formulating a meaningful mandate for monetary policy.

It is important to realize that the hypothesis advanced here to explain congressional behavior does not require that congressmen understand the analytical relationship between interest rates and the inflation rate. Congressmen do not have to believe that inflation is a monetary phenomenon in order to be constrained by the fact that fiat money creation cannot substitute for real resource creation. Congressmen do not refrain from setting interest rates directly in the political process because they believe in economic theories that tell them they cannot act in this manner. They have in fact at times attempted to set rates as part of the political process but, as a pragmatic matter, have backed off when the attempt failed. Interest rate pegging was abandoned in 1951 not because of theoretical consid-

[6]In general, Congress is not explicit about the objectives of programs whose primary motivation is distributional. Such explicitness would only highlight the lack of social consensus over these programs. Explicit statement of redistributive goals also facilitates identification of the costs of such programs and reduces the costs of organizing political opposition.

erations, but rather because inflation caused the pegging scheme to break down. Congressmen feel the need to pass on constituent pressure to keep rates low, at least during those times when politically well-organized sectors of the economy are adversely affected by a rise in rates. As a pragmatic matter, they find that if they try to set rates directly they get blamed for inflation. Letting an autonomous Fed set rates, but leaving the Fed susceptible to pressure when constituent heat is turned up, while not accepting responsibility for the consequences of that pressure, represents a pragmatic solution to a political problem.

It has been contended above that congressional attitudes toward monetary policy are shaped by congressional willingness to use monetary policy to influence the distribution of income. It could, alternatively, be argued that Congress views monetary policy primarily in the way it is viewed by much of the economics profession, namely, as a useful tool for the stabilization of the economy. This latter contention, however, suggests a different behavior on the part of Congress than has actually been observed. It suggests that Congress should have required the Fed to adopt procedures for formulating monetary policy that are rational from the point of view of effecting macroeconomic stabilization. Congress should have required the Fed to make explicit its macroeconomic objectives through numerical specification of targets. Also, it should have required the Fed to make explicit its procedures for deriving its intermediate and operating targets from those macroeconomic objectives. (Economists disagree over the objectives of monetary policy. All agree, however, that if monetary policy is activist, which it is, then procedures for formulating policy should incorporate these features.) Oversight of monetary policy would involve not only a discussion of the appropriateness of the targets set by the Fed for macroeconomic objectives, but also a discussion of whether the settings chosen by the Fed for its intermediate and operating targets would in fact achieve the macroeconomic objectives. Finally, the congressional banking committees would have built a staff of economists with an expertise that would enable them to assess the efficacy of monetary policy in a rigorous manner.[7]

The Federal Reserve

An approach to the political economy of monetary policy that seeks the origin of particular policy actions in the political exigencies of

[7]It could be argued that the recent recession has caused an increase in the extent to which Congress views monetary policy as an instrument for preventing recessions in

the day too quickly ends up as a caricature of policy. The approach followed here is to seek to explain the general framework for Fed decision making as determined by the need for the Federal Reserve to solve particular problems of how to implement policy in the context of constraints imposed by the political system. The most general formulation of the problem that the Federal Reserve must solve is how to formulate monetary policy in order to achieve macroeconomic objectives, given the importance the political system assigns to the distributional consequences of monetary policy. In particular, the Federal Reserve must design procedures for formulating policy that allow it to vary interest rates in order to achieve macroeconomic objectives within a political system sensitive to the distributional implications of variations in interest rates.

The Congressional Shadow

Congressional willingness to pressure the Fed to use monetary policy in a way that produces a politically desirable redistribution of income does not imply a consistently inflationary monetary policy. By failing to specify a mandate to guide the conduct of monetary policy, Congress becomes only one of many influences on monetary policy. The Fed itself must be concerned with erosion of public support for its autonomy caused by inflation. It is argued below, however, that the Fed's need to find ways of coping with congressional pressure on monetary policy has been a major determinant of the way in which policies are formulated. Constitutionally, the Fed owes its existence to Congress. This fact endows Congress with a pervasive influence over monetary policy that extends well beyond any intermittent ability to influence particular actions of the Fed.

The monetary policymaker is motivated by a sense of civic responsibility, more specifically, by a belief that he can formulate a monetary policy that will promote macroeconomic objectives generally

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that, during the recession, Congress became acutely aware of the extent to which recessions reduce government revenue. This awareness could have caused Congress to attach increased importance to having available the use of an expansionary monetary policy to counteract recessions. Evidence in support of this argument would be the numerous bills introduced in 1982 requiring the Fed to set explicit targets for macroeconomic objectives. (See, for example, the bills introduced by Congressmen Conyers, Cranston, Dingell, Garn, Fauntroy, Patman, Moynihan, Quayle, and St. Germain.) Examination of these bills, however, reveals the standard congressional language berating the Fed for causing "high" interest rates and blaming a wide variety of ills on these "high" rates. When it no longer seemed advantageous to blame the Fed for "high" rates, congressional interest in this legislation disappeared. This experience does not indicate a sustainable congressional interest in making monetary policy a useful tool for economic stabilization.

considered desirable by society. From the perspective of the monetary policymaker, the ability to pursue such a policy requires an institutionally autonomous Fed; the authority to formulate policy must reside at the Fed, not somewhere else. Congressional concerns, therefore, exercise a pervasive influence on the way in which monetary policy is formulated. Monetary policy emerges as the pursuit of macroeconomic objectives within a framework that the Fed views as permitting it to retain its institutional autonomy. Several of the salient characteristics of this framework are summarized below.

In pursuing monetary policy in a way that will preserve its independence, the Fed must be cognizant of the multiplicity of groups that vie to influence monetary policy. These groups generally possess different primary objectives. To prevent the formation of a coalition capable of threatening its institutional autonomy, therefore, the Federal Reserve must at most times pursue a policy of targeting multiple objectives. In this way, the Fed will not appear insensitive to the concerns of any major political group. "We always have to balance multiple objectives. The need to provide sufficient money and credit to sustain the recovery is one; keeping inflation under control is another" (Martin 1984, p. 37).[8]

The lack of a specific mandate from Congress to the Fed to guide the conduct of monetary policy leaves unclear what the Fed must do in order to preserve its institutional autonomy. This lack of a mandate produces a policy by the Fed that is characterized by a lack of precommitment (Hetzel 1984b). It is not in the self-interest of the Fed to make explicit its objectives for policy when there is a probability ex post that those objectives could conflict with the objectives the Fed must pursue in order to maintain its institutional autonomy. If a conflict were to arise between explicit objectives and the objectives that could be pursued compatibly with preservation of its institutional autonomy, then the Fed would suffer public embarrassment by appearing political. From the perspective of the Fed, a policy characterized by a lack of precommitment allows the pursuit of macroeconomic objectives generally considered desirable, in a framework that preserves for it the ability to counter threats to its institutional autonomy. The priorities among macroeconomic objectives can be altered if necessary to defuse the formation of a coalition capable of threatening Fed autonomy.

[8]This explanation for the multiplicity of objectives of monetary policy need not rule out other explanations. In particular, in the intellectual environment within which policy has been formulated over the recent past, it has been assumed that monetary policy should pursue multiple objectives. The relevant issue was presumed to be how to trade off among multiple objectives.

Similarly, a policy of nonprecommitment endows the Fed with the ability to modify, when necessary, the extent to which it varies interest rates to achieve macroeconomic objectives in light of congressional concern for the redistributive consequences of changes in interest rates. Again, the Fed retains the ability to defuse periodic congressional threats to its institutional autonomy. From the perspective of the Fed, nonprecommitment allows it to assuage congressional hostility that arises from the heat of the moment, but that possesses the potential to limit permanently its autonomy.

An unconstrained procedure for formulating policy need not (and in the author's opinion does not) make particular policies regularly susceptible to political pressures. The Fed keeps in mind the need to preserve public support for its institutional autonomy. It must be concerned about the impact of the rate of inflation on the credibility of its argument that an autonomous Fed is necessary to ensure a low rate of inflation. It must also be concerned about the credibility of its argument that an autonomous Fed is necessary to avoid a politically partisan monetary policy. The assumption that particular policies are only infrequently affected by a desire on the part of the Fed to defuse situations that could potentially result in a limitation of its autonomy, however, still allows the absence of precommitment to exercise a far-reaching influence on the character of monetary policy. (See Barro [1983] for one elaboration of these consequences.)

The concern of Congress for the distributional consequences of changes in interest rates exercises an all-pervasive influence on the way in which policy is formulated. It is argued in Hetzel (1985b) that this influence is a major reason for the persistence of the "lean against the wind" characteristic of monetary policy. This phrase was intended by the Fed to capture its perception of monetary policy as countercyclical. The phrase "lean against the wind," however, is more aptly used to describe the persistent characteristic of policy in which money market rates (since 1970 the federal funds rate) are set in light of the contemporaneous state of the economy. (See Hetzel [1984a] for evidence that this characteristic of policy continued into the 1980s.) A policy of "lean against the wind" allows the Fed, from its perspective, to vary rates in order to achieve macroeconomic objectives. At the same time, by varying the level of rates from the prevailing level in response to the contemporaneous behavior of the economy, the Fed builds in a rationale for increases in rates, in terms of the state of the economy, that can be used as a defense against a Congress concerned about the distributional consequences of increases in rates. If Congress attacks the Fed for increasing rates, the Fed can always seek

public support with a defense readily explainable by reference to the existing state of the economy.

Money Supply Targeting

Congressional concern for the distributive consequences of the behavior of interest rates precludes any sustained attempt by the Fed to implement monetary policy through money supply targeting. Given the concern of Congress for interest rates, the Fed would endanger its ability to defend its autonomy if it adopted procedures whereby rates are regularly determined as a by-product of achieving a money supply target. If it adopted such procedures, situations would arise over time where the Fed would have limited its ability to control rates in a way that would allow it to defuse congressional action threatening its independence. More generally, within the Fed, operationally significant targets for the money supply are associated with precommitment and are, therefore, unacceptable, apart from very unusual situations (Hetzel 1984a).

Particularly since October 1979, the Fed has adopted the language of monetary control for use in communicating to Congress and to the public. The language of monetary control is useful as a means of communicating to Congress the periodic need to raise interest rates.[9] Discussion of policy in terms of interest rates can convey the wrong message to a Congress predisposed to confuse the ability of the Fed to control rates to achieve macroeconomic objectives with the ability of the Fed to control rates to achieve distributive objectives. Finally, discussion of policy in terms of interest rates can convey at times the undesired message to the public that the Fed is responsible for "high" rates of interest. The Fed associates "high" rates of interest with a lack of fiscal discipline on the part of Congress, while Congress associates "high" rates of interest with tight monetary policies of the Fed.

Money supply "targeting" within the Fed is, in general, most accurately thought of as the use of the money supply as an informational variable. (For a discussion of money supply targeting within the Fed, see Hetzel [1981, 1982, 1984a, and 1984b].) When the Fed believes that the behavior of the money supply is reflecting the behavior of the economy, the behavior of money is employed as one of the informational variables that determines movements of the

[9]Before adoption of the language of monetary control, the Fed often found it convenient to describe its objectives in terms of interest rate smoothing in order to avoid advertising to the political system an ability to control the level of interest rates. To the best of the author's knowledge, there never has been any serious discussion by the Fed of a strategy for smoothing interest rates.

funds rate away from its prevailing value. (Incoming statistics on the behavior of the economy remain the more important determinant of the funds rate, however.) In this way, deviations of the money supply from its intra-yearly "target" are one determinant of changes in the funds rate, although the funds rate is not set in a systematic way to achieve the money supply "target."[10] (Less confusion would arise if the term "benchmark" were employed in place of the term "target.") The view of money as one of many variables offering information about the economy explains in part why the Fed retains multiple definitions of the money supply. A multiplicity of definitions increases the chance that at any one time the Fed will have available to it a definition of money whose behavior captures its perception of the behavior of the economy. Also, in this way, money supply targeting can be made compatible with the "lean against the wind" characteristic of policy described above.

From the perspective of the Fed, desirable behavior of the money supply emerges as a consequence of desirable behavior of the economy, rather than directly as a consequence of achieving money supply targets. Consider the attitude of the Fed toward monetary control during economic recovery. The Fed attempts to keep the funds rate high enough to preclude a resurgence of inflation, yet low enough to sustain economic recovery. The funds rate is moved from its prevailing value to achieve these dual objectives through a process of ongoing judgmental variation. Success in keeping the funds rate high enough to restrain inflation implies only moderate increases in the demand for money, which depends upon nominal income and the price level. Because, in the Fed view, the money supply is demand determined with a funds rate target, moderate growth in money will emerge as a by-product of success in achieving moderate growth in nominal GNP and prices, rather than as a direct consequence of a commitment to hit a money supply target with a low value.

The Fed and Release of Information

In discussing the issue of the information that the Fed makes available publicly, it is useful to consider separately issues pertaining to the formulation of policy and the implementation of policy. With respect to the formulation of policy, debates over the extent of public disclosure of information are generally debates over issues of more

[10]The interval of time from October 1979 to July 1982 is interesting because of the existence of subintervals when the funds rate was being varied in an attempt to achieve an intra-yearly target for M1. It is, however, misleading to characterize this period as one in which the Fed was uniformly trying to achieve a money supply target (Hetzel 1984a).

fundamental importance. The Fed avoids numerical specification of ultimate objectives for monetary policy. It employs instead qualitative objectives such as "low" unemployment and "low" inflation. Through a process of judgmental decision making based upon ongoing observation of the contemporaneous state of the economy, the Federal Open Market Committee (FOMC) develops a consensus over the priorities to assign to achievement of its various qualitative objectives. In light of this consensus, the funds rate is moved from its prevailing value. (Since the early 1970s, when the FOMC has felt that the behavior of the monetary aggregates was reflecting the behavior of the economy, the behavior of these aggregates also influenced the decision to move the funds rate away from its prevailing value.) The motivation for procedures characterized by the pursuit of qualitative objectives and by judgmental decision making derives from the desire of the Fed to avoid precommitment.

In contrast, procedures characterized by the specification of explicit numerical objectives of policy and characterized by model-based derivation of intermediate and operating variables from the fundamental objectives of policy move the policy process in the direction of precommitment. Publicly announced, numerically specified objectives would constrain the ability of the Fed to alter its objectives in an ongoing fashion. Any alteration of such objectives would require the specification of new objectives, and this action would inevitably serve to draw criticism from affected groups. Also, ongoing respecification of objectives would suggest a lack of consistency in policy. Debate over the extent of Fed disclosure of information in the formulation of policy is usually a more fundamental debate over the appropriate procedure for formulating policy. In particular, it is a debate over the appropriateness of current procedures as opposed to procedures that entail at least some degree of precommitment to publicly announced, numerically specified objectives of policy.[11]

The Fed offers practically no information to the public on the implementation of policy, for example, on the values of the operating variables targeted by the New York Open-Market Desk. This

[11]The Fed perceives itself as open because it announces publicly its intentions with respect to its qualitatively formulated objectives. The best example occurs when the Fed desires to make a reduction in inflation its primary objective. In this task, the Fed feels constrained by the price-setting and especially wage-setting behavior of the private sector. The chairman of the Fed goes to great lengths at such times to announce publicly that the Fed will not accommodate price- and wage-setting behavior that anticipates continued inflation. The publicity surrounding Fed attempts to influence the price-setting behavior of the private sector causes the Fed to perceive itself as open with respect to its objectives.

behavior is one aspect of the way the Fed attempts to solve the general problem of how to vary interest rates to achieve macroeconomic objectives in a political system that is sensitive to the distributional consequences of changes (increases) in rates. In this respect, current procedures represent the culmination of an evolutionary process. In unusual situations of "crisis" when the Fed wants to have an impact on the expectations of the public, it will associate particular actions of its own with a change in rates. Specifically, the Fed makes use of the announcement effect of a change in the discount rate. More generally, however, the Fed avoids associating its actions with changes in market rates. For example, changes in the discount rate are justified by the desirability of bringing the discount rate into line with market rates. More commonly, without public announcement, the operating variable targeted by the Desk is altered in a way that causes a change in the funds rate. Over time, the market distinguishes between this policy-induced change in the funds rate and the random daily movements in the funds rate, and money-market rates change accordingly. In this way, the Fed avoids newspaper headlines such as "Fed Raises Rates." Such media characterization would encourage criticism of the Fed for engineering "high" interest rates.

Also, a significant increase in rates effected at one time would serve as a lightning rod for public criticism. The same increase effected gradually over a period of time is less likely to attract criticism. If the market is aware of Fed intentions to increase the level of rates significantly, however, money market rates will respond immediately and fully. The Fed loses its ability to increase rates gradually. (The Fed's own rationale for the desirability of withholding information pertinent to the implementation of policy is detailed in Goodfriend [1984]. On this general issue, see also Dotsey [1984].)

A Congressional Mandate

The political feasibility of establishing a congressional mandate to guide the conduct of monetary policy is considered in the remainder of the paper. The current mandate from Congress to the Fed is too general to possess any significance. Section 2A of the Federal Reserve Act requires the Fed "to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." The "ranges of growth or diminution of the monetary and credit aggregates" are to be set "taking account of past and prospective developments in employment, unemployment, production, investment, real income, productivity, international trade and payments, and prices" (Board 1984, p. 6). An example of a meaningful mandate

would be one in which the above language is replaced with language making stabilization of the price level the sole objective of monetary policy.[12] Whether Congress would formulate and then effectively oversee implementation of such a mandate depends upon the strength of constituent pressure to use monetary policy as a vehicle for affecting the distribution of income and the political rewards for using monetary policy in that fashion. As long as distributional concerns are of paramount importance, there is no possibility of a consensus over the principles that should guide the conduct of monetary policy and no possibility that Congress would establish a mandate to guide the conduct of monetary policy.

Milton Friedman (1977, p. 18) has offered the generalization that government programs change drastically between academic conception and implementation as they pass through the political system:

> All of us . . . have tended to follow the attitude: Well, now, what we need to do is to figure out the right thing. If only we can tell them what the right thing to do is, then there's no reason why able, well-meaning, well-intentioned people should not carry out those ideas. But then we discover, over and over again, that well-intentioned, able people have passed laws, or have established institutions—and lo and behold, they don't work the way able, well-intentioned people expected or believed they would work. And it isn't an accident that that happens. It happens for very systematic, explicit reasons.

[12]The discussion in the section "The Federal Reserve" suggests that the issue of whether to establish a mandate to guide the conduct of monetary policy should not be viewed as one of imposing constraints on the formulation of policy where no constraints are currently imposed. The formulation of monetary policy is constrained by the political environment in which it operates. An explicit mandate would replace the present, poorly understood constraints with clearly understood constraints (see Hetzel [1985c].) In this respect, the neo-Keynesian paradigm used to defend a discretionary monetary policy is misleading. According to this paradigm, the private sector enters into arrangements that restrict its subsequent ability to respond to macroeconomic shocks. For example, it contracts in nominal terms. In contrast, the monetary authority retains an ability to cope with unanticipated macroeconomic shocks because it does not precommit its future behavior. This "flexibility" of the government relative to the private sector is the basis of proposals for a discretionary, activist monetary policy to stabilize the economy.

According to the view advanced in this paper, this paradigm is misleading because it ignores the political constraints on discretionary monetary policy. (Brunner [1981] expresses this idea.) In terms of their effect on voting behavior, the distributive consequences of monetary policy are considered by the political system to be as important as the macroeconomic consequences. As a result, much of the apparent "flexibility" of the monetary authority to effect a stabilization policy disappears, and the apparent comparative advantage of the government relative to the private sector in dealing with macroeconomic disturbances diminishes.

Friedman's observation is consistent with the contention of this paper that congressional attitudes toward monetary policy are shaped by distributional considerations. Academic proponents of stabilization policies consider only the macroeconomic aspects of the policies they espouse. The importance to the political system of the distributional consequences of these policies, however, shapes their implementation in ways that their original proponents do not envisage. The transformation of policies between academic conception and political implementation is obvious in the case of proposals to use wage and price controls in order to reduce the costs of moving to a lower rate of inflation. Anyone who reads the congressional hearings from the 1940s, 1950s, and 1970s on price controls will realize that the distributional consequences of these controls were what preoccupied politicians. The application of wage and price controls reflects this reality and, consequently, is never as originally envisaged by their academic proponents. In this respect, monetary policy does not differ from wage and price controls.

If Congress believes that it is politically advantageous to retain the ability to influence monetary policy to affect the distribution of income through influencing the behavior of interest rates, then its self-interest will lead it to shun a clear mandate for monetary policy. Similarly, if Congress desires to retain the ability to employ an inflation tax, it will be unreceptive to the idea of a meaningful mandate.

It is, however, not inevitable that Congress will be unreceptive to establishment of a mandate to guide the conduct of monetary policy. It has been argued above that Congress is unlikely to establish such a mandate as long as its attitude toward monetary policy is influenced by redistributive concerns. Over significant periods in the past, however, Congress has been unwilling to use monetary policy as a vehicle for the redistribution of income. The presidential campaign of William Jennings Bryan was built upon the premise that government should control the price level to influence the distribution of income between creditor and debtor classes. Bryan's defeat ensured the existence of the gold standard until the start of World War I. Majority political opinion favored the gold standard because under it the price level was not under the control of the government. Under the gold standard, the government was insulated from political pressure to manipulate the price level to redistribute income. Two factors are discussed below that influence the extent to which Congress is likely to view monetary policy from the perspective of the distribution of income.

The first factor is the ability of politicians to assemble a political constituency that will benefit from the redistribution of income. Home

building and construction are examples of sectors of the economy that have comprised such a constituency in the past. The political influence of these users of credit relative to suppliers of credit has diminished, however. The introduction in the late 1970s and early 1980s of financial assets available in small denominations that pay a market-determined rate of return has created a broad class of politically conscious savers. Also, the increase in the number of older voters has enhanced the political influence of savers. It has become less advantageous politically for a congressman to campaign on a platform of "low" interest rates.

The second factor is the difficulty individual congressmen experience in associating themselves with the income transfers effected through monetary policy. It was argued above that monetary policy is a politically inefficient means of redistributing income in part because its costs, inflation, are not hidden. Because congressmen must influence monetary policy indirectly in order to avoid association with these costs, it is difficult for individual congressmen to reap political benefits from exerting pressure for "low" interest rates. This difficulty accounts for the low prestige of the congressional banking committees. Commenting on this lack of prestige, *The Washington Post* (22 April 1984) wrote of the author's senator: "His committee assignments—Banking, Housing, and Urban Development and Commerce, Science and Transportation—are among the least visible in Congress." Woolley's (1984, p. 134) scholarly examination leads him to the same conclusion:

> The most important characteristic of the Banking Committees seems to be the relatively modest quantity of highly selective pork barrel material benefits they control and, probably as a consequence, their generally low prestige and power. Powerful committees such as Appropriations, House Ways and Means, and Senate Finance all have substantial ability to distribute benefits and influence policy. The Banking Committees, with their relatively meager capacity to bestow benefits widely, have been less attractive assignments. Lower power and prestige are associated with high rates of turnover because members attempt to move to more desirable posts. Most members seem to have little interest in the substantive policy issues before the committees.

"In the House, almost everybody on the Banking Committee participates on the pork barrel subcommittee on housing—which has a big staff—and very few participate on subcommittees having to do with monetary policy—which get very little staff" (Woolley, personal communication, 1985).

In sum, with respect to the question of whether Congress is likely to establish a meaningful mandate to guide the conduct of monetary

policy, there are, on the one hand, reasons for believing that Congress will not be amenable to establishment of such a mandate. Monetary policy, if not anticipated by the public, does influence real variables. It is tempting politically to seek votes from groups that benefit from the associated distributive consequences of the real effects of monetary policy. In addition, Congress can be expected to resist foreclosing the possible future use of inflation as a means of raising revenue that does not require explicit action to raise tax rates. On the other hand, it is more difficult than formerly to put together a coalition that can benefit from "easy money" without arousing opposition. Finally, monetary policy is a politically inefficient way to redistribute income because of the difficulty any one congressman has in identifying himself with the "benefits." It is unlikely, therefore, that Congress will insulate monetary policy from the influence of the political system by establishing a mandate to guide the conduct of monetary policy, but it is still a possibility.

Conclusion

A mandate to guide the conduct of monetary policy would clarify the responsibilities of the Fed. As long as the congressional perspective on monetary policy is heavily influenced by those aspects of monetary policy that pertain to the distribution of income, however, Congress will remain unwilling to establish such a mandate. There is little likelihood of establishing a political consensus on matters that concern the redistribution of income from one group to another. Congress may well desire to retain the ability to influence the behavior of interest rates without accepting responsibility for "high" rates of interest or inflation. It may also desire to retain the ability to use monetary policy as a means of raising revenue. In these cases, Congress will continue to fail to furnish the Fed with any clear guideline for what the Fed must do in order to preserve its institutional autonomy. Monetary policy, however, is a politically inefficient means of redistributing income. This consideration suggests that a mandate requiring the Fed to stabilize the price level is, if not inevitable, at least a politically viable possibility.

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PRICE-LEVEL STABILITY AS THE GOAL OF MONETARY REFORM

Leland B. Yeager

Robert Hetzel considers whether it is politically feasible to require the Federal Reserve to aim at stabilizing the price level. It is not entirely clear to me whether he would allow the Federal Reserve to target its open-market operations on this goal directly or would require it, instead, to make some monetary aggregate grow at the steady rate thought conducive to price stability. Anyway, he seems to take the economic desirability of a stable price level for granted.

I would like to see earlier economic assessments of the price-level rule taken up again and extended. (In his paper and especially in a companion paper, January 1985, Hetzel does quote from congressional discussions of the 1920s.) Nowadays, the doctrine of rational expectations discredits an activist policy of trying to manipulate real macroeconomic variables. In that way it favors the more modest policy of simply avoiding the monetary disturbances that movements of the price level would symptomatize. Renewed interest in the "Austrian" school directs critical attention to the Austrian charge that a stable price level is somehow undefinable or unnatural or both and that money-supply growth to forestall price deflation would have undesirable "injection effects."

I must not criticize Hetzel for leaving such issues out of his paper. He explicitly limited himself to the question whether Congress might be persuaded to issue and the Federal Reserve to accept a clearcut policy mandate. He explains how *lack* of clarity serves the self-interests of both. Congressmen can win points with their constituents by exhorting the Federal Reserve to achieve various benefits (low interest rates, in particular) and by blaming the Fed for inflation and

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recession and even for the slow economic growth sometimes alleged to account for inadequate tax revenues and thus for the Federal deficit. (Parenthetically, I would like to see an educational campaign to acquaint Congress and the public with the rudiments of capital and interest theory.)

Lack of a clear mandate preserves scope for Federal Reserve officials to defuse charges of malpractice, to claim credit for good economic results and disclaim responsibility for bad ones, and to play political games in preserving their autonomy. The Fed's notorious secrecy also serves the self-interest of its officials.

Hetzel offers shrewd insights into how the vagueness of the Fed's mandate and, in particular, the vagueness of the directives of the Open Market Committee enhance the dominance of the chairman. More nearly than I, for one, had realized, monetary policy is a one-man show.

Hetzel also reports that despite talk of targeting on monetary aggregates, especially since October 1979, the Federal Reserve still has not shed its traditional preoccupation with interest rates. He explains how its secrecy helps the Fed to indulge this preoccupation. For example, if its intentions were openly known, it could not manipulate interest rates *gradually,* and their sudden movements would attract attention and criticism.

It is gratifying and somewhat surprising that such blunt statements—not only by Hetzel but also by Presidents Black (1986) and Roos (1986)—come from within the Federal Reserve System. One of the few benefits of the System's decentralized structure is that it leaves scope within it for the activities of some "good guys," including, notably, the research officers in Richmond.

Since Hetzel himself has broached the topic of bureaucratic motivations and tactics, I will take advantage of his frankness by asking a few questions. How much and what sort of encouragement and discouragement do he and like-minded researchers receive at the Richmond bank and from the Board in Washington? Is some sort of official or institutional line on monetary theory cultivated within the System? If one is, as it appears to this outside observer, then *how* is that line cultivated, and what incentives do individuals have to conform to it? I have heard a few sketchy rumors—rumors not involving Richmond in particular, though—about the Board's taking financial and other reprisals against dissident Reserve banks and individuals. Is there any truth to such rumors? What courage must dissidents have to speak out?

Before closing, I would like to remark on the method that Hetzel employs. He practices methodological individualism in the style of

the Austrian and public-choice schools. He helps his readers understand what they would want and how they would behave if they were in the positions of a member of Congress or a Federal Reserve official. (One of Hetzel's insights, to mention another example, appears in his explanation of the relatively low prestige of banking committees in Congress.) In this sort of analysis, introspection and imagination are important to recognizing, selecting, and interpreting the evidence for one's conclusions. Hetzel does not restrict himself to the aspects of his topic expressible in numbers. He does not rely, for example, on fitting "reaction functions" to convenient numerical aspects of congressional and Federal Reserve behavior. Doing so would have been pretentious and would have trivialized the topic.

Hetzel departs, in short, from the positivistic methodology that is, or until recently was, quasiofficial within the economics profession. (On the legitimacy of the methodological broadness that Hetzel allows himself, see McCloskey's papers of June and August 1983 and Ebeling's of 1985.) Hetzel's evidence and arguments might be called "unscientific." He constructs no formal model. He offers no "hypothesis" amenable to "testing" in a cut-and-dried way. Far from criticizing him on these grounds, though, I congratulate him on not being intimidated by the slogans of the methodological sermonizers. To refuse to deal with topics that resist fashionably scientific handling may be to set aside truly important issues.

Admittedly, though, it is difficult for a mere outside observer to judge how correct Hetzel's accounts are of what goes on inside the Federal Reserve. Still, all a reader can expect Hetzel to do is what he has in fact done: to lay out his observations, his understanding of people's motivations from what people say and do and from imagining himself in their positions, and his reasoning on how the evidence fits together, and then to invite possible critics to point out errors of fact or logic and to give a better account. This is how historians work, and their methods do indeed seem applicable to the issues Hetzel has been tackling.

In conclusion, Hetzel's paper contributes to further discrediting the old and now dying habit of routinely looking to government for solutions to all sorts of problems. Government is no monolith single-mindedly pursuing some clearcut public good. Instead, it is a congeries of individuals pursuing their own interests (which admittedly are not always narrow self-interest) in the particular frameworks of opportunities and rewards and penalties confronting them.

Hetzel's paper sheds new light on the shortcomings of discretionary and activist monetary policy in particular. It supplies further reasons for tying the monetary authorities down by clear instructions

whose observance or violation can be monitored. I hope Hetzel and I are in agreement in favoring a price-level rule. Such a rule impresses me as about the best that anyone has thought of. It could be framed so as not to deserve the standard objections routinely urged against it. A variant of Irving Fisher's (1920) compensated dollar seems attractive. The government would maintain two-way convertibility between the dollar and whatever changeable physical quantity of gold was equal in actual market value to a specified bundle of goods and services. (The redemption medium need not be gold, however; the system would not be a gold standard.)

Personally, I favor an even more radical monetary reform, one that would involve abolishing the Federal Reserve. Hetzel no doubt finds it an interesting challenge and instructive experience to work from within the Fed as long as it exists. I wonder, though, if he really would deplore its abolition.

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