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Monetary Policy and Karl Brunner

This biographical note discusses Karl Brunner's influence on U.S. monetary policy. Brunner is a monetarist, and monetarists have yet to be admitted to the Fed's inner council. Thus his influence on U.S. monetary policy has been as a critic, not as an insider or adviser. Nonetheless, his influence has been considerable, reflecting his energy as much as his brilliance and his willingness to find common cause with populists, bankers, and others when his careful marshalling of the facts permitted.

His goals are to persuade the Fed to focus on the long run and to use the monetary base and money supply as its policy targets and indicators. The Fed has resisted both ideas. But, at long last prodded by Congress, the Fed gave ground by acceding to the spirit of House Concurrent Resolution 133 in 1975. The resolution expressed the sense of Congress that money-growth targets for the twelve months immediately following be disclosed quarterly at hearings before the House and Senate Banking Committees. Milton Friedman said that the resolution and the Fed's response to it "have produced a major change in monetary policy—perhaps the most important change since the banking acts of the 1930s" [11].

House Concurrent Resolution 133: Some Background

The resolution was introduced originally as Senate Concurrent Resolution 18 by Senator Proxmire, chairman of the Senate Banking Committee, in February 1975. As chief economist for the committee, I was privy to the tensions that the resolution's introduction produced, the fight for it, and the compromises that were necessary to pass it—and the anxieties while waiting for the Fed's response. Up to a point, the Fed cooperated in trying to reach agreement on a compromise resolution, and Senator Proxmire agreed to some of the Fed's suggestions. The sticking point involved the advance-notice provision.

The Federal Reserve had suggested language calling for notice of only "general objectives and plans." At the mark-up, Senator Proxmire led the fight for specificity. He wanted the Fed to set and disclose "numerical ranges" of monetary growth. Nearly all other members of the committee were opposed to the word "numerical." And the discussion indicated that they were opposed because the Federal Reserve was opposed. As a compromise, Senator McIntyre suggested substituting "specific" for "general." Senator Brooke objected to the word "specific" and urged using "objectives and plans for money and credit growth." With further discussion, this evolved into "objectives and plans with respect to the ranges of growth or diminution of monetary and credit aggregates in the upcoming twelve months."

That happened in early March 1975. Until May 1, it was widely believed that the

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Fed would use words and not numbers to delineate the "ranges of growth." On May 1, Chairman Burns told the committee that "the course we are pursuing will promote an increase in M_1 of between 5 and 7.5 percent over the twelve months from March 1975 to March 1976." A small but significant concession to monetarism had been achieved.

Two Implications

Four times a year, the Federal Open Market Committee must think about the next year. Judging by the summary records of the pertinent Open Market Committee meetings, the Fed takes this task seriously. The targets are *twelve-month* targets subject to revision every three months. To illustrate, the M_1 target for the twelve months ending the second quarter of 1976 was originally announced as $5\text{-}7\frac{1}{2}$ percent. Three months later the lower limit for the coming year was reduced to $4\frac{1}{2}$. This automatically reduced the second-quarter lower limit to 4.625 percent annual growth. In the same way when the upper limit for first quarter 1976 to first quarter 1977 target was set at 7 percent, the annual growth targets disclosed earlier for the years ending in the second, third, and fourth quarters of 1976 were revised automatically to 7.375, 7.250, and 7.125 percent respectively.

Equally important, once they are made public, the money targets operate as a constraint, or discipline, that causes the Fed to adjust its federal funds rate target more frequently than in the past in order to avoid prolonged wide swings in money growth, such as occurred in the past. On this ground, too, so far, the resolution must be considered effective.

Brunner's Role

House Concurrent Resolution 133 could not have been passed if key members of the Congress, Senators Proxmire, Buckley, Humphrey, and Congressmen Reuss and Patman, had not been persuaded over the years that inflation and recession were accommodated and exacerbated, if not also triggered, by swings in money growth that could have been controlled if the Fed had wanted to do so. They did not reach this conclusion easily. The road to it was marked by a variety of traps, barriers, and illusions, to wit: (1) the excess reserve and liquidity traps into which, respectively, newly created reserves and money fall and lie idle because borrowers and investors have withdrawn from the market, or restated, because interest rates are so low that the risk of capital loss from holding loans and bonds (and even goods) outweighs the cost of hoarding reserves and cash balances; (2) the interest inelastic investment and savings barriers that keep investment and consumption from rising (and falling) when interest rates fall (and rise); (3) the free reserve and interest rate illusions whereby increases in free reserves and decreases in interest rates are regarded as signs of easier money, and vice versa, rising interest rates and decreases in free reserves are used to indicate tighter money, and finally (4) the illusion that inflation and recession appear and disappear independently of monetary growth.

Brunner's work has been instrumental in responding to these traps, barriers, and

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illusions. In brief: "A Schema for the Supply Theory of Money" [1] and "An Alternative Approach to the Monetary Mechanism," co-authored with Allan H. Meltzer [8], the last of three reports prepared for the House Banking Committee in 1964, were especially important in showing that money supply can be controlled if there is a will to do so. "Liquidity Traps for Money, Credit, and Interest Rates," co-authored with Meltzer [10], demolished, for all practical purposes, the liquidity trap. " 'Yale' and Money" [5] helped call attention to portfolio reshuffling, the antidote for the interest inelastic investment and savings barriers. "The Federal Reserve's Attachment to the Free Reserve Concept," co-authored with Meltzer [7], the second of the three reports prepared for the House Banking Committee in 1964, marked the beginning of the end of the Fed's emphasis, at least in public, on free reserves, forcing it to find new clothes for the real bills doctrine. "The Meaning of Monetary Indicators," co-authored with Meltzer [9], and "Monetary Analysis and Federal Reserve Policy" [4] clarified the indicator and target problems, stressing both the importance of monitoring and controlling base and money growth and the misleading content of interest rates as indicators and targets.

Finally, Karl Brunner has helped to refine the theory and assemble the evidence linking our economy's performance to money supply in a number of papers and articles. His testimony before the House Banking Committee in 1964 [2], his comments on Governor Mitchell's testimony at the same hearings [3], and his statement to the Senate Banking Committee in 1975, which is printed in its hearings on Senate Concurrent Resolution 18 [6], were very helpful in the difficult and long educational process that culminated in the adoption of House Concurrent Resolution 133.

Let me close by saying that I am delighted that Karl Brunner continues to work to achieve a sensible monetary policy. In this continuing effort, the position papers he has prepared for the Shadow Open Market Committee are especially constructive.

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