Markham's total argument turns price leadership into either an ineffectual or exotic market practice. His conclusions are sanguine: barometric price leadership gives the same results as competition; price leadership has limited effectiveness even under the most propitious conditions and can be effective only under extraordinary conditions. And if perchance a dominant firm is an effective leader, one need only wait a little while and new firms will emerge to end its dominance (p. 896). Perhaps one should ask whether very different conclusions are not at least equally correct?

ALFRED R. OXENFELDT*

* The author is associate professor of economics in the City College of New York.

Welfare Considerations in Economics: A Reply

Dr. Enke's review of my *Social Economy and the Price System,* in the September (1951) number of the *American Economic Review,* raises issues concerning the scope of economics, the problem of inequality, and the rôle of the state, that warrant some brief comments.

1. The first of these issues is raised by his statement that my book "can hardly be intended for professional economists, for it does not contribute to value theory, income theory, or distribution theory." The central problem of the book is to study the potentialities and limitations of a normative price system as a mechanism for guiding the economic process toward goals of social economy. This involves the application of the theories mentioned to the problems of economic welfare. It is just such applications that constitute the ultimate end and justification for the study of economics, and they have rightly engaged the attention of professional economists from the very beginning. Recent efforts to construct a body of welfare economics on strictly scientific principles leave too much of the welfare out. It is time to shift the emphasis; not so much in the tradition of Pigou as in that of Hobson, Tawney, Cannan, and others.

2. The problem of inequality, again, is one about which many able economists and philosophers have expressed concern. An effort to deal with it dispassionately, in carefully reasoned terms, can hardly be dismissed as "envy of the well-to-do."

3. All intelligent discussion of the rôle of the state as an agency for promoting economic welfare is precluded if proposals for useful action by the state are to be prejudged at the outset as "politically naive." It can be conceded that the state (like all human institutions) is an imperfect agency. But socio-economic problems are mostly collective problems that we can cope with only by collective action.

RAYMOND T. BYE

Monetary Policy to Combat Inflation

Editor's note—In the December, 1949 issue of this *Review,* there was published a statement, "Federal Expenditure and Revenue Policy for Economic Stability," signed by a group of prominent economists. The statement was prepared at a conference sponsored by the National Planning Association and was transmitted to the Joint Committee on the Economic Report. The present statement, also sponsored by the National Planning Association, was prepared at a conference at Princeton, N.J., October 12-14, 1951. The signers were James W. Angell, George L. Bach, Howard R. Bowen, Lester V. Chandler, Howard S. Ellis, Milton Friedman, Albert G. Hart, Charles J. Hitch, Simeon E. Leland, Roland I. Robinson, Paul A. Samuelson, Lawrence H. Seltzer, H. Christian Sonne, Herbert Stein, Henry H. Villard, Donald H. Wallace, and Charles R. Whittlesey.

Other participants in the conference who did not sign were E. A. Goldenweiser, A. H. Hansen, R. A. Musgrave and Jacob Viner. The statement has been printed in a Joint Committee Print, *Monetary Policy and the Management of the Public Debt*, Part 2. In view of its great interest to economists it is reprinted below with complete footnotes.

The program for strengthening America's defenses creates a serious danger of inflation which may be with us intermittently or continuously for some years. It is essential that we deal with this inflation problem more effectively than in recent years and in ways that will promote healthy growth of the economy. This will require a coordinated program of general financial measures adequate to prevent a significant excess of the total monetary demand for goods and services over the total supply, at stable prices. Such a program should include:

Adequate taxation
Economy in government expenditures
Effective control of credit
Proper handling of the government debt
Encouragement of private savings

In addition, there is general agreement among the members of this conference that the government should have power to allocate scarce materials. Most of us also believe that under some circumstances the prevention of inflation requires certain direct controls over wages and prices—either selective or comprehensive; a few of us believe that such controls are unnecessary. We all agree, however, that price and wage controls are, at best, a necessary evil and that a program to prevent inflation, whatever direct controls it may contain, will succeed only if it includes fiscal and monetary measures adequate to eliminate excess monetary demand.

Excess monetary demand can be reduced by taxation that reduces spending power; it can also be reduced by monetary measures that increase the cost or reduce the availability of credit and limit the supply of money. The more we tax, the less we need to rely on stringent monetary policy; the more stringent our monetary policy, the less taxation will be needed to prevent inflation. For example, a government surplus with an easy money policy or a government deficit with a tight money policy might each have the same effect on total inflationary pressure.

While inflation is not the only situation with which monetary policy may have to deal, the present statement deals neither with problems of deflation nor with those of all-out war, but concentrates on the use of monetary policy to meet an inflationary situation during the present defense period. Without implying that the present tax structure is adequate nor that still higher tax rates may not be required, our basic conclusion is that monetary policy should play a more active role in limiting inflation than it has played in the recent past.

Recommendations

The amount that individuals and businesses desire to spend is powerfully influenced both by the volume of credit that is available to them and by the volume of money and other liquid assets they already possess. Monetary policy covers the whole range of measures affecting these influences on spending, and the following recommendations are directed to monetary policy in this broad sense.

Recommendation I

The central contribution that monetary policy can make to the control of inflation is to control the reserve position of the banking system so as to restrict the supply of credit. The main specific technique for restricting the volume of bank reserves is the sale by the Federal Reserve authorities of securities in the open market, re-enforced by a rediscount policy that limits bank borrowing. The reserve position of banks can also be tightened by an increase in reserve requirements, but restrictive monetary policy need not wait for the new legislation this method would require.

In our judgment, the failure to utilize existing monetary powers adequately in the period since the war must bear a significant share of the responsibility for the inflation that we have experienced. In reaching this judgment, we have considered the repercussions of the exercise of such power on the economy in general and on the bond market in particular. It is our judgment that fuller use of existing Federal Reserve powers can make a major contribution to restraining inflationary pressures.

Recommendation II

Fuller use of existing Federal Reserve powers to counter inflationary pressures might on some occasions result in substantial declines in the prices of government securities or substantial rises in their yields. This result would not in itself justify giving up a policy of monetary restriction that is required for economic stabilization. It may, however, call for action from time to time to keep declines in security prices orderly. But we do not believe that Federal Reserve purchases of government securities to maintain orderly conditions need involve any net purchases over a significant period of time that would not have been required by general economic stabilization.

In addition, it may be desirable to temper the use of monetary restriction if circumstances arise in which the contribution of further restriction to economic stability would be too small to compensate for possibly undesirable consequences of the decline in the prices of government securities or the rise in their yields. Among such possibly undesirable consequences are capital losses for banks and other financial institutions; redistribution of income associated with a rise in interest payments; discouragement of saving as a result of fluctuations in government security prices; effects on the terms on which investors will purchase government and other securities; and changes in the willingness of business enterprises dependent on the security markets to make real investments.

It is difficult to predict in advance the extent to which monetary restriction will contribute to the prevention of inflation in any particular situation, or whether any accompanying decline in government security prices or rise in yields will produce seriously undesirable consequences. Hence, the policy of monetary restriction described in Recommendation I must be subject to continuous reappraisal.

Recommendation III

The impact of restrictive monetary policy on the prices and yields of government securities can be moderated by a number of devices. While we have not studied such devices in detail, we believe that the following are sufficiently promising to justify serious examination with a view to possible adoption: (a) the imposition of reserve requirements by classes of bank assets instead of, or in addition to, present requirements against bank deposits, the level of requirements to be lower on government securities than on other assets; (b) the establishment of limits on the aggregate amount of loans and investments other than government securities that may be held by individual banks, the limits to be determined by objective and non-discriminatory rules such as reference to a base date, with provision for transfers of quotas among banks and for reasonable classification and adjustments to care for defense needs and remove inequities; (c) the imposition of requirements that banks hold secondary reserves in the form of government securities equal to a specified fraction of their assets or their deposits. If one or more of these devices were found suitable for adoption, the power to use it should be given to the Federal Reserve authorities. But consideration of these devices or of other measures included in subsequent recommendations should not be made an excuse or occasion for delay in the appropriate use of existing powers.

Recommendation IV

The existing powers of the Federal Reserve authorities over the reserve position of banks should be strengthened by additional legislation (a) giving the Federal Reserve power to increase cash reserve requirements against deposits above the present maximum level and to impose a special reserve requirement against increases in deposits of individual banks after a stipulated date, with provision for reasonable classification and adjustment to care for defense needs and to remove inequities; and (b) making the reserve requirement for banks which are not members of the Federal Reserve System correspond to those of comparable member banks. These additional powers are desirable to improve the long-run effectiveness of the Federal Reserve System, but their absence should not excuse delay in the use of existing powers.

Recommendation V

We make no attempt to offer detailed proposals on the specific types of securities to be issued by the Treasury. We do, however, recommend that a substantial part of the debt be in the form of securities which contain strong incentives for investors to hold them to maturity. As far as possible, the balance of the debt should be in the form of securities that will not give rise to frequent or persistent pressure for Federal Reserve support.

Recommendation VI

In a defense period, selective credit controls (such as those applying to consumer credit and housing credit) can assist in the diversion of particular resources from less essential activities to defense-related uses. These controls will also reduce somewhat the extent to which general monetary restrictions need be applied.

Recommendation VII

We endorse the following statement, made in January, 1950, by the Douglas Subcommittee on Monetary, Credit, and Fiscal Policies:

> . . . the restoration of free convertibility of our money into gold would be neither a reliable nor an effective guard against serious inflation. . . . There is no reason to believe that a requirement of redeemability into gold would promote wise monetary and credit policies; in fact, past experience indicates that it would at times endanger such policies. . . .[1]

Recommendation VIII

Increased saving can make a significant contribution to the restraint of inflationary pressures. Study should be given to the issuance of new types of securities that may encourage saving, such as bonds of constant purchasing power (which might be particularly appropriate for purchase by Social Security and pension funds), annuities in excess of those provided under the present Social Security program, and savings bonds offering strong inducements for retention to maturity by the original purchaser.

Recommendation IX

The policies of government lending and loan-guaranteeing agencies should be made consistent with other fiscal and monetary policies. These agencies exert a significant influence on the cost and availability of credit for major sectors of the economy, and their actions have frequently run counter to the needs of general economic stabilization. In making these recommendations, we are, of course, aware that other aspects of national policy besides general stabilization must be considered.

Recommendation X

Full and effective utilization of monetary powers requires coordination of the policies of the various government agencies whose actions affect the volume and availability of credit—especially the Treasury Department and the Federal Reserve System. We recommend, therefore, that steps be taken immediately to establish an effective coordinating mechanism to ensure that all agencies concerned with monetary problems follow consistent and mutually supporting economic policies.

[1] *Monetary, Credit, and Fiscal Policies,* Report of the Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report, 81st Congress, 2nd session, Document 129, p. 43.

Footnotes by Signers

To the Statement as a Whole

Paul A. Samuelson and Charles R. Whittlesey

This statement points in the right direction but exaggerates the potency of monetary policy relative to fiscal policy, selective credit policies, and other more direct controls. We also believe that many of the policies mentioned should have further discussion, analysis, and observation before being applied even experimentally.

To Recommendation I

Lawrence H. Seltzer

This recommendation contemplates action more violent than I consider necessary or advisable in the present circumstances. Barring a marked increase in the turnover of money, it is only necessary to limit further additions to member bank reserves to the amounts the economy can use without inflation, not to reduce them nor to increase cash reserve requirements. Among the evils from which we have not suffered during the past few years are unemployment, low profits, falling prices, and a stagnant or declining level of output. Inflation is not necessary to avoid these evils, but violent deflation is pretty sure to produce them. Let us by all means strive to keep the expansion of credit within limits that avoid inflation, but let us also avoid violent deflation.

To Recommendation II

Milton Friedman and Roland I. Robinson

We do not concur in Recommendation II. "Orderly markets" has become a semantic cloak hiding the desire to resist all price declines. Moreover, the consequences of monetary action listed as "possibly undesirable" are mostly trivial, imaginary, or—where real—not undesirable.

If truly undesirable consequences should develop, the appropriate remedy would be higher taxes, which would make a lower level of interest rates consistent with avoiding inflation.

To Recommendation III

Milton Friedman

I dissent from this recommendation because the devices listed would reduce the efficiency of our private credit system by altering, in essentially arbitrary ways, relative yields on various classes of private loans and securities. I see no counterbalancing advantage.

Charles J. Hitch

I must oppose as unnecessary, administratively undesirable, and inconsistent with the efficient operation of a free enterprise economy proposals like Recommendation III (b) which involve quota restrictions on the lending activities of individual banks.

To Recommendation IV

George L. Bach and Milton Friedman

These powers are unnecessary. The Federal Reserve already has ample power to control the volume of money through open-market operations; its unwillingness to use existing powers will not be solved by giving it still more power.

Milton Friedman

These powers are also undesirable—the first, because it is less flexible than open-market operations, the second, because its impact depends on the accidental position of the banks on the base date.

Herbert Stein

The proposed measures should receive further examination and be adopted only if thorough study indicates their desirability.

To Recommendation V

Roland I. Robinson

If the last sentence of this recommendation is interpreted as adverse to the use of long-term marketable Treasury securities, I demur.

To Recommendation VI

Milton Friedman

I disapprove of selective credit controls. Such controls, like other "direct" controls, are an inequitable and inefficient means of altering resource allocation. The "interest rate," despite admitted deficiencies, will do a far better job.

To Recommendation X

Lester V. Chandler

While agreeing that better methods of integrating monetary, credit, and fiscal policies are desirable, I disapprove of this proposed method and feel that its full implications have not been adequately considered.

Roland I. Robinson

In a democracy profound disagreement on policy is to be expected. I do not believe that recent policy disputes have created such a lack of reasonable cooperation at the operating level as to require administrative reorganization.

Footnotes by Other Economists Attending the Meeting

The economists whose footnotes appear below attended the conference, but did not sign the statement:

E. A. Goldenweiser

While I agree that vigorous monetary action is essential in an inflationary period, the statement includes so many propitiatory qualifications that the general position loses much of its force. Also there are many matters of detail and emphasis on which I differ. Consequently I am unable to sign.

Alvin H. Hansen

The statement implies that monetary policy is more potent than it actually is. In particular, the third paragraph is far too sweeping in alleging perfect substitutability of monetary for fiscal policy to control inflation. We face inflationary pressures which cannot be controlled by monetary policy unaccompanied by tax increases except at the cost of serious repercussions on production.

Vigorous monetary policy should be undertaken only if its impact on government security prices is moderated by some of the devices advocated in Recommendation III. Hence, I disagree with the conclusion which places much responsibility for recent inflation on the monetary authorities. Expectations caused by Korea were bound to result in price increases; their prevention by monetary action alone would certainly have injured the economy.

Richard Musgrave

Space does not permit me to state the qualifications, on a few major and several minor points, which would enable me to sign. I agree entirely that effective stabilization requires a supporting monetary policy, but I believe that the extent to which the Federal Reserve can or should apply general credit restriction (and the extent to which the disadvantages mentioned in the statement may be avoided) depends greatly on whether measures such as those listed in Recommendations III and V are taken. Also, selective controls, rather than help "somewhat," can do an important part of the job, thus reducing the range of necessary interference with Treasury operations. Finally, the issue is not whether *some* degree of credit restriction can check inflation (it obviously can), but *what* degree of restriction and rise in interest is now needed. Since we know little about this, or the magnitude of adverse effects, the whole is a matter of judgment. Considering the stakes, it is all important that activation of monetary policy be framed so as to minimize the risks involved.

Jacob Viner

I am in agreement with the statement insofar as it stresses the importance of increased use of monetary policy to combat inflation. My unwillingness to sign it is due to my belief that the support here given to vigorous use of monetary policy is too weak and excessively qualified.