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MONETARY POLICY AND THE PRESIDENT'S ECONOMIC RECOVERY PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

OF THE

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WEDNESDAY, APRIL 8, 1981

MONETARY POLICY AND THE PRESIDENT'S ECONOMIC RECOVERY PROGRAM

WEDNESDAY, APRIL 8, 1981

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:07 p.m., in room 4232, Dirksen Senate Office Building, Hon. Roger W. Jepsen (chairman of the subcommittee) presiding.

Present: Senator Jepsen; and Representatives Reuss and Richmond.

Also present: James K. Galbraith, executive director; Bruce R. Bartlett, deputy director; Charles H. Bradford, assistant director; and William R. Buechner, Kent H. Hughes, Helen T. Mohrmann, Mark R. Policinski, Timothy P. Roth, and Robert E. Weintraub, professional staff members.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

Senator JEPSEN. The subcommittee will come to order.

This afternoon the Subcommittee on Monetary and Fiscal Policy meets to hear testimony on the conduct of monetary policy from Mr. Beryl Sprinkel, who is the newly appointed and confirmed Treasury Under Secretary for Monetary Affairs. The success of President Reagan's program for economic recovery depends critically on the Federal Reserve, to which the Congress has delegated its monetary powers. If the Fed does its job badly, the President's program cannot succeed. If money growth is not brought back down to a rate commensurate with our economy's long-term ability to increase production, we will not stop inflation or achieve lower interest rates, and we will not revive saving or investment or balance the budget.

It is encouraging that the administration supports reducing money growth steadfastly. Past administrations have all too often been critical of using monetary policy to fight inflation. They have said this would raise interest rates, be unfair to housing, threaten the viability of thrift institutions, and cause recession and, hence, should not be done.

And all too often the Federal Reserve has found it difficult to slow down the growth of the money supply in the face of these criticisms with the result that inflation has been fueled and preserved. And inflation, in turn, has produced painfully high interest rates, nearly wrecked the housing industry, brought many thrift institutions to the brink of failure, and reduced the Nation's real economic growth.

Clearly, fast money growth doesn't pay. It is, as I said, encouraging that this administration supports reducing money growth steadfastly. And it is encouraging that this administration intends to closely monitor how the Fed is doing and to speak out on the conduct of monetary policy from time to time.

Mr. Sprinkel, I welcome you. I now yield to the distinguished chairman of the Joint Economic Committee, Congressman Reuss.

Opening Statement of Representative Reuss

Representative Reuss. I want to join you in welcoming the new Under Secretary of the Treasury for Monetary Affairs, Beryl Sprinkel, who for at least 20 years has been a staunch helper of this committee, a giver of advice which we have treasured. He is very generous with his time, and now you can expect the Joint Economic Committee to start giving you some advice. I hope it is as wise and as well thought out as the advice you have been giving us.

We are delighted you are here. We all wish you well.

STATEMENT OF HON. BERYL W. SPRINKEL, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. Sprinkel. Thank you very much, both of you. Because of the importance of this subject, I prefer to read the prepared statement into the record. I will be very glad to respond to questions.

Senator Jepsen. The statement that you are going to present, Mr. Sprinkel, will be printed in the record as read. If there is no objection, the Chair seeing none, it is so ordered, and now you may proceed.

Mr. Sprinkel. Mr. Chairman and members of the subcommittee, I am pleased to have this opportunity to appear before this subcommittee to discuss the issue of monetary policy and the President's economic recovery program. I believe that our views on monetary policy and actions can best be understood in the context of the interaction between monetary and fiscal programs. Thus, I will present our views in that context.

First, let me emphasize that I recognize and support completely the independence of the Federal Reserve System under the oversight procedure which the Congress has established. The administration, including the Treasury, neither seeks nor envisages a confrontation with officials at the Federal Reserve over the formulation of monetary policy.

Far too often in the past, the public, the Congress, and various administrations, especially the last one, expected the Federal Reserve to print more money to depress interest rates in the short term. We have learned the hard way that printing too much money ends up triggering higher inflation rates and higher interest rates. This administration does not believe that monetary actions can be used effectively for short run fine-tuning and will not press for money growth which causes more inflation. Instead, we share the Federal Reserve's objective of subduing the inflation tide, and we support their intent of achieving a permanently slower, noninflationary rate of monetary expansion.

We believe that a steady, noninflationary monetary policy is crucial for the success of the President's economic program and necessary to restore long-term confidence in the dollar and improve the international competitive position of the U.S. economy. A strong U.S. economy and a strong U.S. dollar will contribute to renewed stability in the international monetary system.

THE RELATION BETWEEN MONETARY AND FISCAL POLICY

The basic purpose of the changes in tax law and the composition of Federal spending which have been proposed by the administration is to encourage saving, work, and investment. This portion of the fiscal program is intended both to increase the supply of real credit in the private sector and to provide incentives for the private sector to channel that saving into expansion of productive capacity. Cuts in the growth of Government spending, on the other hand, are necessary to insure that the increase in the supply of credit is not simply absorbed by additional Government borrowing. In short, the budgetary program attempts to raise the real growth path of the economy by an increase and reallocation of real credit.

Appropriate monetary actions are essential to the success of this program, but not in the ways which some observers allege. First, we do not look to accelerated monetary expansion to help in the financing of the budget deficits which will be incurred over the near future. The private sector of the economy needs more saving and investment if it is to generate a permanent increase in production and employment. Obviously, Federal deficits will absorb some of the available saving.

However, efforts to hold down or depress short-term interest rates by creating more money are cosmetic at best. Instead, further excessive money growth, which both the administration and the Federal Reserve oppose, would bring both higher inflation and higher interest rates. A permanent, steady, and noninflationary rate of monetary expansion is the device which the Federal Reserve has at its disposal for achieving permanently lower and less variable interest rates.

On the other hand, immediate, severe monetary restriction is not required, as some claim, to offset an alleged inflationary impact of the budget program. If the Federal Reserve does not monetize new debt and the Government is diligent in efforts to bring the budget into balance over the next few years, there simply is no immediate stimulus to inflation in the administration's program.

The task of the monetary authorities, as we see it, is to eliminate the excessive and erratic growth of money which has plagued the economy for more than 15 years and to do so in a manner which has maximum impact on decreasing inflationary expectations. In terms of the administration's program, a permanent reduction of inflation would strengthen greatly the incentives which would result from the proposed budget actions.

Without relief from monetary inflation, the badly needed cuts in marginal tax rates would provide only temporary incentives for increased work, saving, and investment. For example, taxable nominal income would continue to rise faster than growth of real purchasing power. Capital gains would continue to include the artificial, but still taxable, effects of inflation. Capital gains taxes would then continue to be levies on the capital itself. Depreciation allowances would continue to be wiped out by increases in the cost of replacing capital goods.

In short, continuing inflation would ultimately overwhelm any tax incentives which come from the administration's program. In addition, continued uncertainty about inflation would add to investment risk and thereby would counter incentives for investing in long-lived assets.

In this regard, a dedicated effort to reduce the rate of money growth and thus the rate of inflation is crucial for the realization of the full potential of the fiscal program. This is why we applaud and support wholeheartedly a long-term monetary program which will lead to a steady, predictable, and appropriately slow rate of monetary expansion.

We must recognize, however, that the strength of inflationary expectations is an immediate problem. There is no doubt that permanently slower money growth will lead inevitably to a reduction of inflation and that inflation cannot be reduced without such monetary discipline.

However, many economic analysts and commentators argue that fighting inflation with monetary restraint is too costly in terms of lost output and jobs. I do not believe that there is a tradeoff between unemployment and inflation in the long run. However, the shortrun, temporary costs of moving to a permanently slower rate of money growth are an indication of the strength of inflationary expectations. The more quickly expectations respond to the promise of slower and smoother money growth, the smaller will be the output-employment costs of moving to a noninflationary economy. Execution of the President's tax, expenditure, and regulatory reform program is important to reducing inflationary expectations. A key factor is the manner in which the transition to a slower pace of money growth is achieved.

It is an unfortunate fact that the economy has been under persistent inflationary pressure for many years. The lessons of this experience are deeply imbedded in all aspects of current economic behavior. Persistence of high interest rates and continued rapid increases in production costs in the face of weak sales are obvious symptoms of the strength of inflationary expectations. The result is the often cited momentum of inflation, which, in the past, has worked to maintain the pace of price increases through brief periods of monetary restraint.

The lesson is simple. The longer inflation endures, the more difficult is the cure. The best anti-inflation policy is to prevent inflation from ever getting started. Unfortunately we cannot go back and start over. Monetary actions over the next several years must not only reduce the trend rate of money growth but must do so in a way which has maximum impact on inflationary expectations. The economy has to be induced to expect a permanent slowing in money growth. Until that happens, the burden of monetary restraint will fall on economic activity and will be working against the stimulative effects of the fiscal program.

Also, the problem facing the Federal Reserve is compounded by a deep-seated public skepticism—or a "show me" attitude—of waiting for anti-inflationary actions to match intent. The trend of money growth and the associated rate of inflation are presented in chart 1. The Federal Reserve first adopted explicit targets for money in

1970, but these were short-term targets which were cast in terms of month-to-month growth of money. At that time, the trend rate of increase of money was 5 percent per year, and inflation was running at about the same pace.

However, money growth continued to accelerate and a trend of 6 percent was established by 1972. In 1975, targets for the longrun rate of money growth were first adopted, and for the next year and a half, those targets were hit on average.

However, money growth accelerated sharply in late 1976, and the trend was pushed up to more than 7 percent per year by 1979. Despite the welcome shift to direct control of bank reserves in October 1979, money growth continued to be rapid and volatile in 1980, and the trend of money growth remained high. It is against this backdrop that current monetary actions are being evaluated.

It is obvious, therefore, that the Federal Reserve faces a difficult task in convincing the economy that the rate of money growth will be brought down permanently over the next several years. For our part, the administration emphasizes that accelerated monetary expansion is not required to accommodate the fiscal program, and instead we hope the Federal Reserve will stick to its long-term targets.

We believe that this assurance of the administration's intentions and desires will help to weaken inflationary expectations. We also believe that the Federal Reserve should implement its policy of long-term monetary control in a manner which assures the public that the growth of money will be brought down steadily over the next several years. In this regard, the transition to a slower pace of monetary expansion would hopefully avoid short term variability in money growth, of the kind experienced in recent years.

It is true that in less chaotic times, short-run variations in money growth probably would have a small effect on expectations or on economic activity. However, the economy has been subjected to highly variable but generally accelerating money growth over the past 15 years. This experience has encouraged market makers to concentrate intently on each weekly release of the monetary data in an attempt to see if another change in the direction of money growth is underway.

Thus, analysis of shortrun monetary developments has come to dominate longer term considerations, detracting from the crucial concern of what is happening to the trend of monetary expansion. Systematic volatility in monetary growth weakens the credibility of monetary policy and adds uncertainty to the process of business and financial planning.

Obviously, strict control over money growth from month to month is not possible given the current financial structure, and random variability is to be expected. On the other hand, systematic deviations from the target path which persist for several months can be avoided.

A steady and predictable decline in the rate of monetary growth will not only decrease the rate of inflation but promises also to have a prompt effect on inflationary expectations and a minimum disruptive effect on economic activity. We have learned by sad experience that due to the inevitable lags in policy conception, execution, and impact, attempts to fine-tune the economy are not only ineffectual but frequently destabilizing.

As chart 2 shows, the increase in the trend of money growth since the mid-1960's reflects a highly variable pattern of shortrun monetary expansion. Over the period there have been four instances where money growth fell below trend for at least a quarter: 1966, 1969–70, 1974–75, and 1980.

In each of these cases, the unexpected monetary restriction temporarily reduced output and employment, causing a minirecession in 1966 and the shallow recession of 1969–70, and aggravating the depressive effects of oil price increases in 1974–75 and 1979–80. Moreover, each instance was followed by a sharp acceleration of money growth and the trend of money growth actually tended to increase.

The evidence is clear. Chart 3 shows that short-term variations in money growth have a strong effect on growth in spending in the economy. As seen in chart 2, this effect has been translated into temporary shocks to production. Furthermore, this volatility in money growth has induced sharp gyrations in interest rates. However, these short doses of monetary restraint have had no effect on either the expected or the actual rate of inflation. We hope that current monetary control procedures will prevent such oscillations in the future.

TECHNICAL FACTORS FOR CONSIDERATION

We do not presume to dictate monetary policy procedures to the Federal Reserve. However, since the success of the economic recovery program is so dependent on achievement of the monetary targets, we are vitally concerned that results match intent. Therefore, we urge the Federal Reserve to continue its efforts to improve monetary control. In our opinion, there are several items that should be reviewed.

The Federal Reserve has adopted objectives for growth of five separate monetary aggregate series during 1981. In addition, it has presented targets for M1A and M1B with and without adjustment for projected shifts into NOW and automatic transfer accounts—ATS. This approach creates at least two problems for interpretation and evaluation of current monetary actions.

First, the change in regulations covering NOW and ATS accounts has introduced the obvious problem of projecting the magnitude and composition of shifts of funds among various classes of deposits. While this situation is temporary, it creates the problem this year of determining just how much of the growth of M1A and M1B is the result of Federal Reserve actions and how much is due only to the transitional shifts in deposits.

It seems, for example, that the magnitude of these shifts so far this year has been much larger than the Federal Reserve had projected and that there has been less growth in "adjusted" M1B than is evident in the actual series.

Shifts among the various types of deposits occur in response to market choices by holders of liquid assets. The Federal Reserve can change the structural incentives but it cannot control the public's distribution of liquid assets among the various measures of money. As in 1980, the Federal Reserve might be forced during this year to alter its plans and targets for actual money growth as information becomes available about the magnitude and distribution of deposit shifts into NOW/ATS accounts.

It will be difficult, especially in the near term, for market observers to determine whether the money stock is on target. Prolonged deviations can occur either because the Federal Reserve incorrectly estimated the shifts or because the Fed is actually off target.

Second, multiple targets tend to confuse perceptions of the actual stance of monetary actions, especially given the tendency of the various measures of money to show vastly different patterns of growth over periods of several months. Yet, the Federal Reserve does not have the ability to correct a deviation from the target path of one measure of money without influencing the other measures. This raises the question of priorities in the spectrum of money targets.

Due to the inevitable secular as well as cyclical changes in the relative growth rates of various measures of money as institutional changes proceed, I prefer to evaluate the stance of monetary actions in terms of reserve aggregates, such as the adjusted monetary base or adjusted bank reserves. Such aggregates are effective long-term constraints on money growth and are under the direct control of the Federal Reserve.

It is our belief that a meaningful reduction in inflationary pressures requires that the rate of growth of the adjusted monetary base be reduced smoothly and persistently by about one-half between 1980 and 1984, with little further downward movement by 1986. If that pattern is followed, we are quite confident that: (1) systematic deviations of money growth from the trend will be reduced; (2) the trend of money growth will fall; (3) the level and variability of interest rates will decline; and (4) inflation will abate significantly.

Due to our concern about stable policy implementation, we welcome the Federal Reserve's interest in perfecting the monetary control mechanism. In particular, we hope that the Federal Reserve will decide to move to a flexible, market-oriented administration of discount policy, and we applaud its consideration of restoring contemporaneous accounting. I would add that I am pleased by the increased emphasis on reserves and relaxation of the Fed funds restraint since October 1979.

SUMMARY AND CONCLUSIONS

In summary, we are supportive of the Federal Reserve's stated intent to reduce growth in monetary aggregates. The monetary excesses of the past 15 years cannot be corrected quickly and the Federal Reserve's stated intention for 1981 is a prudent first step.

We believe the Federal Reserve's control mechanism would be improved if the Fed funds constraint were removed completely and efforts were concentrated on controlling the adjusted monetary base or adjusted bank reserves. Adoption of contemporaneous reserve accounting and a flexible, market-oriented discount rate policy would also help the Federal Reserve to match actions with policy, and thereby restore credibility to their anti-inflationary efforts.

Avoidance of extreme monetary volatility is also necessary if policy direction is to be believed. A steady, but persistent decline in monetary growth over the next 4 years will promote stable economic growth, declining inflation and stable, but lower interest rates. These are objectives that we all share. Reduction of inflationary risks will improve the performance of capital markets, both in the fixed income and equity sectors, and enhance the probability of achieving our objective of increasing capital formation and improving productivity.

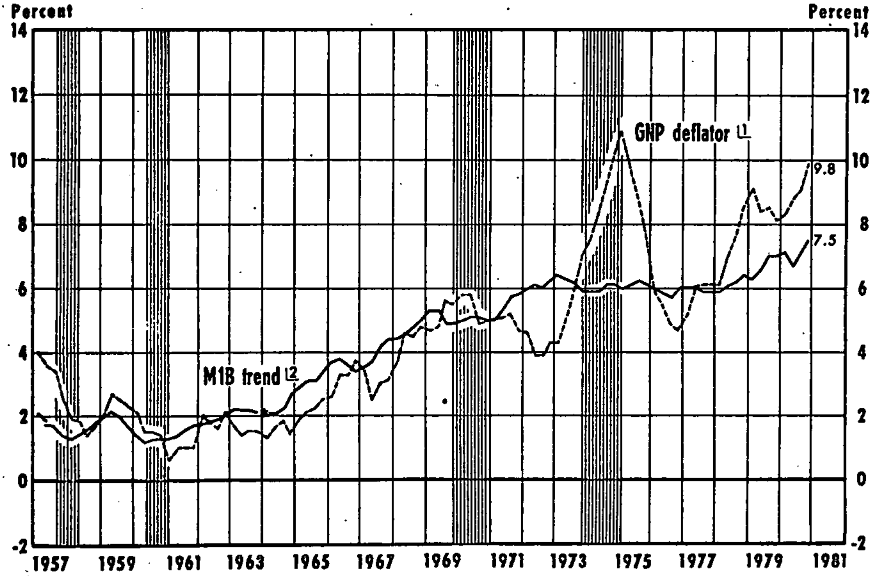
It is naive to expect that inflation will quickly disappear, but there is no reason why substantial progress cannot be achieved over the next several years. The immediate task is to establish the credibility of anti-inflationary policy and thereby break the back of the expectation that inflation is a permanent phenomenon. Only in this way can the accumulated costs of more than 15 years of monetary excesses be reduced and the full benefit of the administration's economic program be realized.

It should be emphasized that adoption of the administration's tax, expenditure, and regulatory reform program will create an environment which will make it easier for the Federal Reserve to achieve our common monetary policy objectives. Implementation of the administration's four-faceted economic recovery program will ultimately eliminate stagflation from the U.S. economy. Thank you.

[The charts referred to by Mr. Sprinkel follow:]

CHART 1

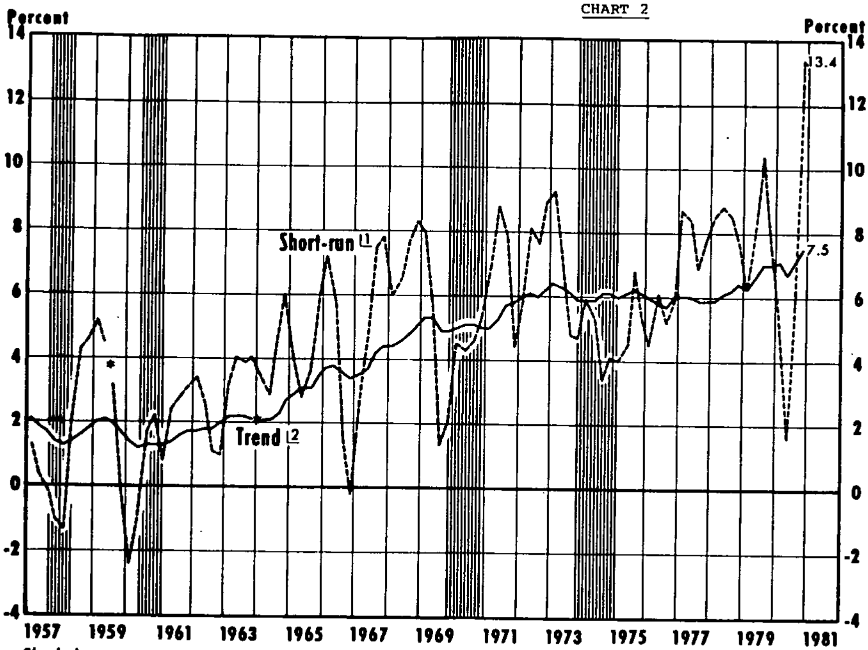
Rates of Change of Money and Prices



1 Four-quarter rate of change,
2 Twenty-quarter rate of change; data prior to 1st quarter 1964 are M1.
Latest data plotted: 4th quarter

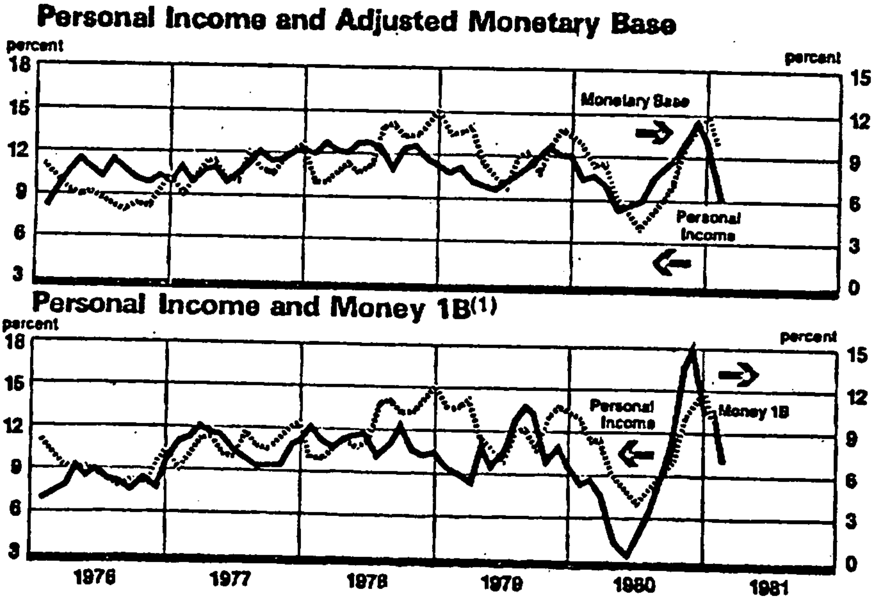
Rates of Change of Money Stock (M1B)

CHART 2



Shaded areas represent periods of business recessions.
[1] Two-quarter rate of change; data prior to 3rd quarter 1959 are M1.
[2] Twenty-quarter rate of change; data prior to 1st quarter 1964 are M1.
Latest data plotted: 4th quarter

CHART 3



(1) Currency and all checkable deposits at depository institutions.
All data are seasonally adjusted six month compound annual rates of change.
Source: Board of Governors of the Federal Reserve System;
Federal Reserve Bank of St. Louis; Harris Bank

Senator JEPSEN. Thank you, Mr. Sprinkel. You indicate that you recommend the President's program. You assume money growth would be cut in half by 1984, if I interpreted that correctly.

Mr. SPRINKEL. Yes. The monetary base.

Senator JEPSEN. This implies cutting the basic M1B measure of money growth about 1 percent a year.

Mr. SPRINKEL. That is approximately correct.

Senator JEPSEN. Is that decline fast enough?

Mr. SPRINKEL. It is fast enough to make progress. It is not fast enough to immediately restore stable prices. The problem, of course, is that drastic, unanticipated downward reductions in the money supply in the short run adversely affect employment and production; all of the things that we want to achieve in this economy.

We are attempting to bring it down in a gradual way, and in the process change inflationary expectations, so that the adverse effect on the real sector of the economy would be minimized.

Senator JEPSEN. The reason I asked is that, if inflation is linked to money growth on a 1- to- 1 relationship, or nearly so, and especially, because it lags money growth 1 or 2 years, this appears to be a pretty slow trend.

Mr. SPRINKEL. It is considerably faster than anything we have seen in 15 years, because we have gone the wrong direction. It is conceivable that we should go faster. Recently, the actual achievement since last fall, as you know, has been somewhat below target.

I am not urging that we make up for that lost ground. If we can get money growth down sooner, in a stable sort of way, I suspect there would be no objection; certainly no objection from me.

Senator JEPSEN. Would it be desirable in your opinion for the Federal Reserve to set forth a 3-, 4-, or 5-year money growth target path, or road map?

Mr. SPRINKEL. It has been my opinion for many years that very shortrun objectives contribute little to efficient decisionmaking in the private sector. In contrast, attempting to lay out a program over a number of years in a way that makes the public believe you mean it has very beneficial effects upon private planning and private decisionmaking.

I have spent most of my life in that part of the economy. I would be in favor of seeing an extension of the targets by the Federal Reserve. The administration, as you know, has set out a plan in the tax area, and also in the spending area that extends beyond 1 year. I think it would be favorable if we could see such action by the Federal Reserve.

They do state that they plan to be persistent and continue over a number of years, but there are no numbers past the first year.

Senator JEPSEN. This year, the Federal Reserve projects 9 to 12 percent growth in nominal current-dollar gross national product. It is targeting monetary growth to accommodate the midpoint of this range, of 10½ percent. Now, this is a full point higher than nominal gross national product grew by in 1980.

How are we going to stop inflation if the Federal Reserve now fuels a jump in the nominal growth of GNP with very little prospect, the rest of this year at least, of a significant increase in real growth?

Mr. SPRINKEL. As you know, in the first quarter of this year there was a very rapid increase in total spending and also in the real sector of the economy. I do not expect that rate of rise to be repeated throughout the year, and therefore the average will be well below the first quarter.

I think it is reasonable to believe that changes in total spending in this year will be somewhere in the 10, 11 percent range. It will not make a major contribution to reversing inflation this year. We do not expect significant progress in 1981; however, we do expect significant progress in 1982 and subsequent years, even late this year.

I would not be surprised to see us gradually break into the high single-digit inflationary territory late this year. I don't think much progress will occur on average for the year on the inflation front. We could, of course, get much lower rates of increase in the last half of the year in GNP increases if we were to squeeze very severely on money in the short run.

The difficulty would be that unanticipated swings toward severe restraints would lead to—I fear—significant short-run increases in unemployment, and reduced output. Therefore, I guess I plead guilty to being a gradualist, but a persistent gradualist, one where we actually do make progress—and we are hoping for progress—as we have outlined progress for the year. The Federal Reserve has projected an attempt to accomplish progress. It is a good first step.

Senator JEPSEN. In trying to figure out the relationship between the deficit and money growth, or to identify that, would you answer this question for the record: Do large deficits or increases in the deficit require the Fed to speed up the printing process?

Mr. SPRINKEL. No, sir. They do not. There have been occasions in our history where large increases in deficits were accompanied by sharp acceleration in money growth. There have been other occasions where it did not happen.

The important thing to keep in mind, from my point of view, is that if we permit deficits or some other influence to lead to sharp acceleration in money growth this will bring very pleasant responses in the economy in the very short run.

Senator JEPSEN. Does slowing money growth increase interest rates?

Mr. SPRINKEL. At worst only in the very short run. It has been conventional in many quarters to argue that slowing money would lead to very sharp increases in interest rates. It turns out that is not the way markets work. I spent most of my life in those markets. It has become increasingly clear, especially in the last decade, that markets react exactly in the opposite fashion. That is, if you slow money in the very short run you may see a very slight increase in interest rates. But the ultimate effect is that with a very short lag of a few months you will begin to see a slowdown in income creation, and this generates less demand for credit. And third, you begin to positively influence inflationary expectations. The price effect or the inflation effect begins to move into the marketplace, and in fact, the slower the money growth the lower the interest rates.

Let me approach it from another point of view; that is, from what the facts are in the real world. If it is true that pumping in a lot of dough leads to low interest rates, which is the opposite side of the question, we should be able to look around the world at the countries that have the most rapid increase in the money supply and expect them to have the lowest interest rates. But that is exactly wrong. They are the countries that have the highest interest rates. The countries that have persistently had low rates of money growth, such as Germany, Switzerland, and in recent years Japan, have also had the lowest interest rates.

We want a low interest rate trend in this economy for many reasons. We are convinced the way we get there is to encourage slow stable growth in money.

Senator JEPSEN. One last question before I yield to Congressman Reuss.

In further examining the interest rate-deficit relationship, what would happen to interest rates if the Fed held money growth down, even reduced it significantly year after year, and the deficit increased or remained high?

Mr. SPRINKEL. There is some empirical evidence on that score. Obviously the effect of a deficit, of a large deficit, within a given level of money increases tends to raise rates somewhat. It is a force working toward higher interest rates. However, slow money growth tends to work in the opposite direction. We have examples. In fact, some of the countries I just mentioned, Germany and Japan, both run much larger deficits as a percentage of their GNP than we do. I'm not arguing that is good. From my point of view deficits are a bad thing. One of my responsibilities is to manage the financing of that deficit and the maturing debt.

I don't like deficits; I didn't like them before I got here. They do one of two things. Either lead to excessive money creation or they absorb savings that cannot go into the private sector.

It turns out that in the case of Germany and Japan, even though they have large deficits relative to their GNP compared to us, they have low interest rates, lower than ours, and their reason is they have managed their money supply much better than has the United States.

Representative REUSS. Thank you, Mr. Chairman.

Mr. Sprinkel, you have now been here as Under Secretary designate or as Under Secretary for a couple of months. Has the Federal Reserve during that period performed satisfactorily as far as you are concerned?

Mr. SPRINKEL. I think so. There has been a significant slowing in monetary growth since last fall. I could look at the numbers last fall and say that the rate of growth in the money supply was one of the highest that had ever existed in my adult lifetime. This, of course, has resulted in very high interest rates and no abatement of inflation.

Since that time there has been significant moderation in the rate of growth in the money supply. The Federal Reserve has consistently stated that they intend to continue pursuing that policy. I believe them.

Representative REUSS. Last week, according to press reports, the Federal Reserve—observing the short-term interest rate affected by the Federal funds rate going down—started pegging it so that it stayed within the 15–20 percent bracket. Do you approve of that?

Mr. SPRINKEL. No, sir. In my statement I indicated that I would prefer a further relaxation, or even an elimination of the Fed fund constraint, and I will explain why.

Let us take a period where for some reason demands for credit are receding and interest rates are trending downward and we happen to hit the low end of the band. This would occur at a time when the economy is beginning to slow down and/or inflation is beginning to recede. There is really only one way that the Federal Reserve can buck that market and prevent rates from coming down if the inate forces in the market are trying to do so, and that, of course, is by selling securities in their open market operations.

When they do that, that tends to reduce reserves from the system. And it tends to put at least temporary upward pressure on short-term interest rates. However, when you reduce the reserves in the banking system, that puts even further downward pressure on the money supply. You cannot control both rates and quantities. Economists have known this as long as the books go back in history. Certainly Adam Smith knew that. Therefore, it is one or the other.

My own preference is to control the quantity of money, not the price of credit.

Representative REUSS. Yet the Federal Reserve, by its actions on the Federal funds interest rate, has caused several billion dollars worth of distress in the stock market and the bond market this week; is that not true?

Mr. SPRINKEL. I am not sure that was brought on by the Federal Reserve. The bond market was recovering, I understand, of late. There was a press release of some minutes that—of the Federal Open Market Committee—allegedly had at least a temporary dampening effect on markets. I gather those minutes indicated that the Fed fund rate was on the lower end of the target and they were unwilling to permit it to come down further.

Representative REUSS. That's what you don't like, isn't it?

Mr. SPRINKEL. I want steady, slow rate of reduction in monetary growth.

Representative REUSS. I don't think you answered my question. What about the pegging of the Federal funds?

Mr. SPRINKEL. Trying to peg rates interferes with achieving steady growth in money.

Representative REUSS. Don't you think the Fed's action had something to do with the movement in the money markets and stock market and the bond market over the last few days?

Mr. SPRINKEL. Writers have a very tough problem of explaining each and every day why the market went down and up. Probably many of those movements are random movements, but if your job insists that you find a reason, they will find it, and I don't know why those markets go up and down in any one day. It might have had something to do with the minutes, but I have no way of being certain.

Representative REUSS. Leaving writers aside for the moment, isn't it logical that if the central bank starts bidding up interest rates that the bond market would want to go down?

Mr. SPRINKEL. It depends on whether we really believe that the Federal Reserve is long run pursuing a policy that is likely to lead to higher interest rates. To do that long run, the thing that would convince me is statements and action out of the Federal Reserve that they were going to pursue a highly expansive monetary policy. Then I would be worried about bonds. They have not stated that.

Their recent actions have not indicated that they were going to—that they have moved toward monetary expansion. Therefore, I find it very difficult to blame the recent movement of the market on what the Federal Reserve has been doing lately.

Representative REUSS. But you agree that the Federal Reserve action—as revealed by their minutes a determination to peg the Federal funds rate at 15 percent or higher—is in error?

Mr. SPRINKEL. I wouldn't want to say error. I would prefer that they concentrated on controlling monetary aggregates, not interest rates.

Representative REUSS. Have you made known your feelings?

Mr. SPRINKEL. Yes, sir, I have.

Representative REUSS. What did they say?

Mr. SPRINKEL. You will have to ask them, sir. I am not privileged to repeat their statements.

Representative REUSS. In your statement, you had this to say about expectations: "The immediate task is to establish the credibility of anti-inflationary policy and thereby break the back of the expectation that inflation is a permanent phenomenon." Don't you think that the best way to beat inflationary expectations is to stop inflation?

Mr. SPRINKEL. Yes; that's absolutely critical.

Representative REUSS. You can't beat that, can you?

Mr. SPRINKEL. The problem is, it takes a long time, as was previously suggested, between the time you begin to slow money growth and you have a visible effect on inflation. Most of the studies I have seen, and I have done some of them myself, suggest you are out there a year and a half before you begin to have much effect.

What I am arguing is that we don't want to wait that long. We want to convince the American public that both the administration and the Federal Reserve have a dedicated effort underway to slow money growth and reduce inflation in the future. If we can change expectation in the interim, we can avoid any serious distortion of production, unemployment, and that, to me, is very important.

Representative RICHMOND. Mr. Sprinkel, one point of agreement. I think we all can agree that a balanced budget would do more to reduce inflation than possibly anything else we could do right now. Would you go along with that?

Mr. SPRINKEL. I believe a balanced budget will make it easier for the Federal Reserve to control money. However, it is very clear that we need not wait until the budget is balanced to make significant progress on the inflation front. Witness Germany and Japan.

Representative RICHMOND. Don't you think this administration should be working toward a balanced budget rather than toward an imbalanced budget? Tax cuts that will only require more Federal printing presses to print more money and therefore more inflation?

Mr. SPRINKEL. Yes, sir. I not only believe that we should, but that we are.

Representative RICHMOND. We are not doing it. We are not doing it under the present Reagan budget.

Mr. SPRINKEL. I think we are. We have offered the largest array of spending cuts that I remember in my lifetime. We have, at the same time, attempted to encourage savings, investment, and work through tax adjustments. In the meantime, if we wait until we get a balanced budget to actually start encouraging the supply side of the economy, too much time will elapse.

At one time in my life, many years ago, I believed that we should never cut taxes until we had the budget balanced. I have changed my mind. And the reason was that each time a balanced budget threatened, one of two or three things occurred. Either we run into a recession and you don't have a balanced budget, or the money was spent and you don't have a balanced budget, or a consumer-oriented tax cut occurred and you don't have a balanced budget.

We are not willing to wait until the budget is balanced to initiate incentives for saving, investing, and working.

Representative RICHMOND. With a little leadership from this administration, the Congress would be very willing to vote a balanced budget. Many of us feel that without a balanced budget, there is no way we are ever going to get a handle on inflation, which clearly is the worst problem we have in the United States today. Would you agree with that?

Mr. SPRINKEL. Inflation is one of the very worst that we have, that along with slow growth or stagflation—whatever word you use.

Representative RICHMOND. Tax cuts should be something that we would reconsider?

Mr. SPRINKEL. I don't think the tax cuts should be reconsidered. I know of no way of encouraging the savings flow necessary to finance the projected capital formation, the projected improvement in productivity unless we permit the American public to save more of the money that they earn, and that means tax cuts at the margin designed to influence action.

Representative RICHMOND. Let's give the American public a tax exemption on savings up to the first $2,000 per married couple. That would guarantee that the thrift institutions would be able to go back into business and generate long-term money for mortgages. That I would consider an immediate item that Congress could vote that we could put to work immediately and it would save thousands of savings banks and thrift institutions throughout the country. It would provide a market for mortgages so you could get back into the homebuilding business. That I would consider a tangible thing we could do. But to have a general across-the-board tax cut, I don't think is going to help our inflation problems.

Mr. SPRINKEL. I think it would help the savings problem.

Representative Richmond. A direct tax credit would help. That would force any middle-class person to put money back into a savings account.

Mr. SPRINKEL. Let me say something about our program and your proposal, which is similar to others I have heard.

In general, our proposal attempts to cut marginal rates at all levels of income. We do not need massive increases in savings by any one person to get very large effects for the total economy. We have had experiences in the past of cutting marginal tax rates, and it has properly influenced total savings.

Now there are many targeted types of proposals that have been offered that certainly make some sense. We anticipate, as you well know, that there will be another tax bill later this year that will attempt to take up some of the structural proposals by the Congress and others, and we will give very serious consideration to the one you mentioned.

Representative RICHMOND. How do you feel about removing the tax deductibility on consumer credit as a means of, again, curbing inflation and cooling down the economy?

Mr. SPRINKEL. I don't think it would make a major effect on inflation. I do think in general, probably not this year but over the long run, we should ask ourselves whether or not tax deductibility on interest is the way we want to encourage the economy to grow. It encourages, for example, the issuance of long-term debt instead of equity. This creates some problems in the corporate sector.

It encourages individuals to borrow rather than save. This is something we should ask. It is not something I think is of the essence but, as a long-term structural question, should be considered.

Representative RICHMOND. On one side, we could consider removing the tax deductibility on all interest. On the other side, we could consider changing the Tax Code on such items as capital gains and secondary income, dividend income or whatever.

Mr. SPRINKEL. Our tax proposal does, in fact, result in a very substantial cut in the capital gains rate. It moves from a present peak rate of 28 percent down to 20 percent when the last installment of the tax cut occurs.

Representative RICHMOND. I can see the concept of removing tax deductibility on all interest and on the other hand making dividends taxable at a much lower rate.

Mr. SPRINKEL. The one difficulty, as you are well aware, is that many of us enjoy those benefits. That is, all of us homeowners typically have large mortgages, and we deduct that interest, and there are many people who have a direct interest in whether or not they can deduct their interest, and I do not want to be interpreted as recommending that we make this change at the present time.

Representative RICHMOND. I am not advocating removing the tax deductibility on primary homes; but, the less interest that is deductible, the more capital will be developed, faster than any other way you could do it in the United States, by forcing people to invest in equity instead of interest-bearing certificates.

Mr. SPRINKEL. It would be a helpful development over the long term.

Representative RICHMOND. You seem to contradict yourself in your statement. You say if the Federal Reserve does not monetize new debt to bring the budget into balance, there is no immediate stimulus to inflation in the administration's program. And then you say the economy has to be induced to expect a permanent slowing in money growth. Until that happens, the burden of monetary restraint will follow economic activity and will be working against stimulative effects. The two statements do not really jibe.

Mr. SPRINKEL. The stimulating effects that I referred to in the latter statement relate to stimulating savings, investing, and work. It does not refer to stimulating total monetary demand.

In the first case, I was arguing that we would not get a sharp increase in total spending if, in fact, we kept money under control. Hence, there would not be an inflationary impact of the program.

Representative RICHMOND. Thank you, Mr. Chairman.

Representative REUSS. Secretary Sprinkel, what is the policy of the administration with respect to intervening in the foreign exchange market with respect to the dollar?

Mr. SPRINKEL. I expect to appear before the appropriate congressional committee fairly shortly and lay out our total intent in that area. Let me just say, as Secretary Regan, I believe, stated to the press a few days ago, that under extreme circumstances we might well authorize intervention, and as he announced, we did so on the day that President Reagan was shot.

Representative REUSS. This committee is an appropriate committee.

Mr. SPRINKEL. I will be back.

Representative REUSS. Let me pursue it, if I may. In cases, of course, like an attempted assassination, I think there would be widespread agreement that intervention is what you have to be prepared to do.

What about, however, in other cases? For example, review the history of the last year. We were heavily into deutsche marks and out of deutsche marks. We intervened rather heavily. In studying that record both as a bank economist and as an Under Secretary, are you satisfied, or would you have intervened more or less?

Mr. SPRINKEL. I find it difficult to say what I would have done. It has long been my judgment, Congressman Reuss, as I am sure you are well aware, that I believe that large competitive markets are highly efficient. The exchange market is indeed one of those with billions of dollars changing hands frequently.

I find it very difficult to believe that treasuries or central banks can consistently indicate better than can the market what a particular exchange rate should be. We expect to pursue policies in line with that basic viewpoint. That viewpoint is shared, to my knowledge, by Secretary Regan.

Representative REUSS. On another important question of international monetary policy, what is your view about the exposure of the American banking community to loans to the less-developed countries, particularly the nonoil producing less-developed countries? Are we overextended, underextended, or about right?

Mr. SPRINKEL. I don't have the knowledge to answer that precisely. The regulators, of course, have much better information concerning that than I. I am well aware of the fact, as you suggest, that large deficits in the nonoil producing developing nations have been financed to a very considerable extent by the commercial banking system of the world, including our own banks.

I come from a private bank where we had significant foreign loans. All of the banks that I know anything about set up a credit committee which carefully allocates credit between various countries based on perceived risks. And I do not want to say that no place in this country is there a banker that made bad judgments, but on the whole I have found bankers to be fairly sensible people. And barring catastrophe, I would not expect the banking system per se to be in serious jeopardy. The regulators are policing this problem quite regularly.

Representative REUSS. Turning to the subject of our exports, the Congressional Export Caucus is of the opinion that the proposed cuts in Eximbank financing are not in the national interest. What would your view be on that subject?

Mr. SPRINKEL. I disagree with that, I guess, if I understand the statement properly. It is my judgment that we have had a series of subsidies across this Nation that have resulted in misallocation of resources. We have attempted to remove, in our proposed budget, or at least reduce subsidies in many areas including the subsidy provided by the Eximbank. We have not eliminated that subsidy.

I think we should not—the world should not believe that this is unilateral disarmament on our part. I do not think that it is fair that we should eliminate all of the export subsidies in the United States and then permit our friends abroad to continue theirs at present or even higher levels.

I can assure you that this administration will be working vigorously to reduce export subsidies from other nations. If we are successful, I would hope that we could move further to reduce our own export subsidies.

Representative REUSS. With respect to the World Bank family and the regional development banks—African, Asian, et cetera—do you think the United States gains from its continued participation in them? And what do you think should determine the proper level of participation in those institutions?

Mr. SPRINKEL. On net balance, I am convinced we do gain. As you know, this administration has indicated that over time it expects to gradually shift emphasis toward greater emphasis on bilateral loans and aid. We have worked very hard at trying to reduce budget outlays in this area. IDA–6, we have reduced that as far as we thought we could reduce it without having to renegotiate very difficult agreements with our friends abroad.

I think it is important that the Congress provide the funds to live up to the obligations that were incurred by the prior administration. We feel it is our responsibility to honor those commitments, and I am hopeful that the Congress will agree with us.

We do have, of course, a sizable vote in most of those institutions. We expect to place people in there as executive directors from the United States that will be very well-informed on what our national interests may be. We hope that we can encourage them to make prudent loans and to avoid excessive loans.

On the other hand, we think on net balance we certainly do gain from membership in those multilateral lending banks.

Representative REUSS. The dollar share of the world's total foreign exchange reserves has declined markedly in the last few years. There is a formal alternative proposal before the IMF called the substitution account. This proposal would offer an additional international currency to the dollar and permit, to the extent wanted and under controlled conditions, the exchange of dollars for SDR's or some other international medium. Do you see any future for the substitution account idea?

Mr. SPRINKEL. Not if I do my job correctly. I doubt that there will be massive pressure toward reviving the substitution account, which was considered, as you know, and debated extensively over the past year or two. The real pressure for that movement, in my judgment, was due to the fact that the United States pursued over a number of years highly expansionary economic policies, leading to very serious domestic inflation and deterioration in the relative value of the dollar. Consequently, holders of dollars were searching aggressively to find a way out of that box.

If we correct the domestic inflation/stagflation disease that has become very serious in the United States—and I believe we will do so—I expect the dollar to be firm most of the time. In fact, it has been firm for some months now, even though up to now the discussion of the effects of President Reagan's economic program is mostly promise, not results. We have not yet passed the tax cut. We are only starting the monetary adjustment. We are just beginning the deregulatory effort. We are just beginning the spending adjustment.

The market has received this movement very kindly, it seems to me. And to the extent that we make the world believe that we have a currency that is useful, that will maintain its value vis-a-vis other currencies, I do not expect great pressure toward substitution accounts or other devices to get out of dollars.

Representative REUSS. You earlier referred to the admirable economic performance of the Japanese economy. And you pointed out some reasons for their successes.

Isn't one of the reasons—one among many—for the success of the Japanese economy that nominal wage increases in Japan have rather closely followed productivity increases, rather than bounding well ahead?

Mr. SPRINKEL. That has been true in recent years.

I happen to have been in Japan in 1974, when the inflation rate at that point was running about 25 percent; when the so-called spring offensive was moving in on the nation. There was great concern about wage increases going up 30, 35 percent; which bore no relation whatsoever to the productivity improvement.

What it did bear relation to was the productivity improvement plus inflation.

Now, beginning in 1975—and the results were beginning to show up in 1974 and subsequent years—the Japanese have pursued exactly the kind of monetary policy that I think we should pursue.

Their inflation rate in 1975 dropped, I believe, to about 9.5 percent. And it has been in the low- to mid-single-digit numbers since that time. As the inflation rate came down, so did the wage increases come down.

And now, with low rates of inflation, there is a fairly close relationship between the rate of productivity improvement and the rate of wage increases.

If we had zero inflation, I would expect a very close relationship between productivity and wage adjustments.

We have, incidentally, in the United States in recent years, had negative productivity. It turns out that our wage increases, on average, have been less than our inflation. And that is what economic theory suggest should be the case; it has indeed been the case.

What we want to do is to get productivity up and inflation down, and then we will find a very close relationship between productivity improvements, on the one hand, and wage increases on the other.

Representative REUSS. There has been considerable interest in Washington, both before and after her visit here, in Prime Minister

Thatcher's monetary policy in the United Kingdom in the last 2 years, since the Thatcher ministry has been in power.

Can you explain briefly what their monetary policy has been, and how it has worked, and what lessons there may be for us—granted enormous differences between their situation and ours?

Mr. SPRINKEL. You asked on the monetary side. I have been intensely interested in that issue, in trying to resolve in my own mind where the truth actually lies.

Let me tell you what I know for sure, and then I can guess with you what I believe I know for sure.

First, we know that Mrs. Thatcher has argued consistently for reducing the rate of growth in the money supply. This is one of the important facets of her total package, just as it is an important facet of ours.

Second, I have been traveling to the United Kingdom at least annually, and frequently biannually, for many years. I have many friends there, who are supposed to be experts in money. On each occasion, I ask which of these money supply series should I concentrate my attention upon.

I have not done empirical work on the U.K. series, as I have at home. And almost inevitably, they tell me M3.

The third fact that I know for sure is that, during the first year and one-half of Mrs. Thatcher's tenure, M3 soared way above the projected trend rate. It soared following removal of certain direct constraints, called a corset, on the banking system.

One other fact we know is that over the last year plus, the U.K. economy has been in a very serious recession. And, in fact, the inflation rate has dropped from a peak of about 22 or 23 percent, down to levels in the high single-digit range, 7 or 8 percent. I don't average over the last year, but refer to recent months.

Now, I thought perhaps here was an example where a major country had suffered a serious recession, even though we had massive monetary stimulus. And yet, they brought the inflation down, even though they had massive monetary stimulus. And I thought that this might be the first case I could find of such an example.

I am now convinced that M3 was not the proper target to follow. I have been to London recently——

Representative REUSS. Excuse me. Did you say that you were not convinced or now convinced?

Mr. SPRINKEL. I am sorry. I am now convinced that M3 was the wrong series to follow in that particular set of events, because of the change in the structure in the banking system—the controls in the banking system.

It turns out that if you look at what happened to M1—or, better yet, the monetary base—they have been in a condition of significant monetary restraint for approximately a year and one-half; perfectly consistent with what is happening in the financial markets, what is happening in the economy.

Very recently, there has been some rise in the monetary base. The leading indicators in the United Kingdom, when I was there a few weeks ago, were pointing up. There is hope that the recession is about over, if not already over.

In the meantime, massive improvement has occurred on their inflation rate. And I interpret it to be consistent with all of the other evidence that I have observed; but I must confess, I was for a while concentrating too much attention on M3.

My suspicion is that now that the controls are out of the way, that the M3's and the M1's and the base will tend to track much more closely together. But for a year and one-half, they did not.

Representative REUSS. What was the inflation rate when the Thatcher government came in?

Mr. SPRINKEL. I believe it was around 15 percent. It was building, and it reached a peak of 22 and 23, some months after she took office. I am not certain of the exact number when she took office; it was below that peak.

Representative REUSS. Congressman Richmond.

Representative RICHMOND. Mr. Secretary, you spoke of Japan in relatively flattering terms.

I think we all agree, if this Nation only spent 1.5 percent of its gross national product on defense, we would be in considerably better shape, too.

Mr. SPRINKEL. Yes, sir. That is one of the major advantages that they have enjoyed. They have not spent a significant portion of their total income on national defense.

There have been other benefits they have enjoyed, as you are well aware. They save a much higher percentage of their total income. They are at the top of the array of nations, as to how much is saved. And they have had a very low rate of money growth. Plus, they have a highly educated and skilled population.

Representative RICHMOND. Homogenious, and low crime rate, and all the other things. It indicates that Japan and Germany—the greatest economic stimulus they have had is that they have not had to spend a great deal of their own money on national defense; and we have.

I know that you believe that most everything can be solved by monetary policies.

Mr. SPRINKEL. No, sir. I do not.

I believe that inflation can be solved by lower money growth. I do not think money only matters. I have indicated very clearly that I believe supply-side factors encouraging savings, working, and investing also matter.

Therefore, I think it is unfair to say that I believe that money can solve everything.

Representative RICHMOND. We discussed savings before, and we both agree on that.

I think your whole comment about the idea eventually of removing the tax deductability of interest would radically change the investment climate in the United States, toward equity, which is precisely what the major industries need, in order to retool and modernize.

But we have a deeper problem in the United States, and I cannot quite put my finger on it. It is the national malaise, a morale problem which ties right into productivity. You do not seem to have the unions understanding how serious the problem of the Nation is. Our basic industry is in incredibly bad shape, when it comes to competition with any other modern industry in the world—not secondary industry, but the basic industries: steel; coal; railroads; copper; and aluminum.

Those industries require billions of dollars to build new plants, and they are just in probably worse shape than any other Westernized industry in the whole world.

Mr. SPRINKEL. Yes, sir.

Representative RICHMOND. Along with your policies, how would you propose to radically change the physical condition of American business?

You will never get much productivity until you modernize your facilities.

Mr. SPRINKEL. Yes, sir.

Representative RICHMOND. There is no question that the average worker in America works as hard as anyone else. We have proven it in our own factories. Every time you add a modern piece of equipment, you get more productivity.

Mr. SPRINKEL. I couldn't agree more, sir.

The way you improve the capital in our important industries is to create incentives to save and invest. If you concentrate only on the investment side, it won't happen unless we generate the savings. We have a capital recovery, a generous capital recovery program that has been proposed, attempting to try to offset the negative effect that inflation has had on corporate activity over the last decade or so.

As inflation became more and more serious, depreciation allowances were inadequate. It was too costly to replace, because we could not get adequate capital recovery.

We are trying to change that.

In the meantime, we are trying to bring the inflation rate down, so this will not be the same negative factor.

May I add one further point you referred to?

You referred to American labor not understanding the seriousness of the problem. I am not sure that is true. I hear lots of complaints about the fact that standards of living are not rising. They are unhappy about that, as I am. I see no evidence that they are pushing wage rates far in excess of inflation plus productivity.

I think the inflation was not brought on either by labor or by business. It was brought on by mismanagement in this city. And this is where we are going to change it.

Representative RICHMOND. I think mismanagement and big business helped. You cannot excuse the big three automotive companies, who just did nothing whatsoever to improve their automobiles, and let the Japanese and Germans take a large portion of their market.

Mr. SPRINKEL. I remember very well, we had a problem of controlling oil and gasoline prices well below the marketplace—long before President Carter—which encouraged the automobile industry to believe that demand for large cars was a permanent demand.

All of a sudden, we did eventually what we should have done a long time ago—deregulation—which changed the incentives. And then we asked them to adjust promptly, to what foreign producers have been doing for a long time. And it caused great difficulty.

Again, many of their problems were a direct result of policies foisted upon them—by inadequate policies in the Congress and in the administration.

Representative RICHMOND. Thank you, sir.

Senator JEPSEN. One last question.

Why don't we trade enough gold, barter it or sell it, to finance the purchase of the oil we want to put in reserve?

As I understand it, we have about 260 million ounces of gold. At the present $500 price, even after deducting the par value, trading off just 8 or 9 million ounces would fund next year's addition to the oil reserve.

That would find a pretty good hunk of money in that budget that we are looking for.

Mr. SPRINKEL. As you know, the prior administration had a policy of selling gold, for some period of time; and they eventually ceased selling.

That is what was happening when we came into office. We have been thinking about this problem of what our gold policy should be. Nothing has been resolved yet, partly because the Congress set up a Gold Commission, as you are well aware, and their purpose is to advise the administration on the role of gold in the monetary system.

We would hope to get that advice before we make a serious effort at formulating a total gold policy.

I must confess that I have heard some other schemes of financing that oil reserve, which I find much more foolish than the one you suggest.

The last time I checked, we have something like $135 billion worth of gold—in that order of magnitude. I do not believe for one moment that we should get rid of most of that gold, for national security reasons, if none else. It is important that we keep it.

I am not sure that we need $135 billion worth o' gold, especially if you recognize that we know something about how gold prices respond over periods of inflation and less inflation. I have published a book on this subject, some years ago.

It turns out that gold as an investment does extremely well in real terms, in a period of accelerating inflation. It does rather poorly in periods of decelerating inflation. It does horribly in periods of deflation.

We are moving, I hope and believe, into a period of deceleration in inflation, and we may be sitting on $135 billion worth of gold, as valued today, that may be worth less tomorrow. If we are successful in getting inflation down, it is entirely possible.

Certainly, that is a factor that should go into the consideration of a total gold policy, which we do not have at the moment.

Senator JEPSEN. Anything else?

Representative RICHMOND. No.

Senator JEPSEN. Thank you very much. The subcommittee is adjourned.

Mr. SPRINKEL. Thank you, sir. It was my pleasure.

[Whereupon, at 3:25 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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